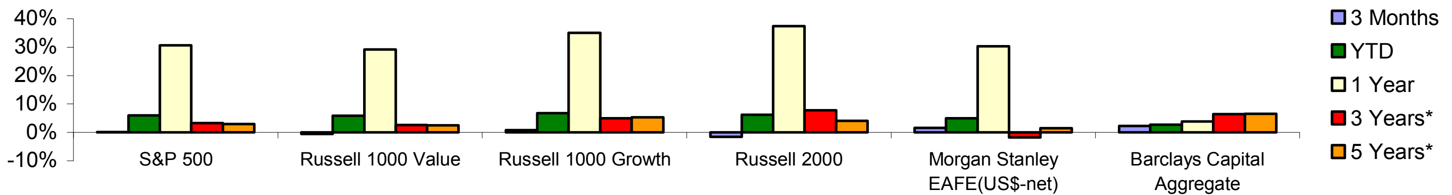
Timberline Investment Management, LLC

MARKET OVERVIEW — **June 30, 2011**

Market Description	Index	3 Months	YTD	1 Year	3 Years*	5 Years*
General Stock Market	S&P 500	0.10%	6.02%	30.69%	3.34%	2.94%
Large Company Value	Russell 1000 Value	-0.50%	5.92%	29.22%	2.59%	2.52%
Large Company Growth	Russell 1000 Growth	0.76%	6.83%	35.01%	5.01%	5.33%
Small Companies	Russell 2000	-1.61%	6.21%	37.41%	7.77%	4.08%
International Stocks	Morgan Stanley EAFE(US$-net)	1.56%	4.98%	30.36%	-1.77%	1.48%
General Bond Market	Barclays Capital Aggregate	2.29%	2.72%	3.90%	6.46%	6.52%

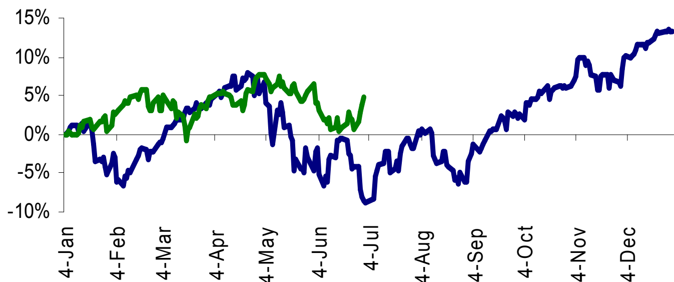


ECONOMIC OVERVIEW

	Statistic	Most Recent*	3-month Prior	3-month Change	12-month Prior	12-month Change
Long-term Rates	10-year Treasury Yield	3.18%	3.47%	**-8.36%**	2.97%	**7.07%**
Short-term Rates	Effective Fed Funds Rate	0.07%	0.10%	**-30.00%**	0.09%	**-22.22%**
Consumer Inflation	Consumer Price Index*	225.964	221.309	**2.10%**	218.178	**3.57%**
Producer Inflation	Producer Price Index*	204.2	195.5	**4.45%**	184.8	**10.50%**
Job Growth	Non-farm Payrolls	132079	129899	**1.68%**	130908	**0.89%**
Average Workweek Hours	Avg. Weekly Work Hours	34.3	34.3	**0.00%**	34.1	**0.59%**
Economic Output	Industrial Production*	92.9815	92.3543	**0.68%**	89.9025	**3.42%**

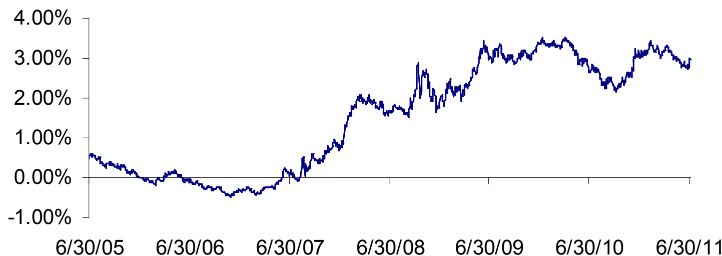
**Economic data for certain statistics are as of the prior month end. Data is from sources believed to be reliable but is neither guaranteed nor warranted and is subject to revision without notice. Data is provided for your analysis and used at your own risk. Market returns greater than 1 year are annualized. Timberline provides information herein for informational purposes only and should not be considered an investment recommendation.*

S&P 500 Comparison



It is interesting to see notable dips in the second quarter of 2010 and 2011. Perhaps a normal and temporary seasonal slowdown is being confused with a broad economic slowdown due to the very slow nature of the current recovery. Perhaps a normal uptick in fall economic activity may be good for the equity markets.

Treasury Yield Curve: 10yr Yield - 1yr Yield



The Treasury Yield Curve (the difference between long-term rates and short-term rates) has a good history as a leading indicator. When very positive, as it is now, there are usually positive expectations for the economy. When negative, as seen in 2006 and 2007, the outlook is usually negative. It looks like the yield curve anticipated the market issues of 2008. Today's positive yield curve appears to be very optimistic.

As rightfully and often said in the investment industry, past performance is not indicative of future performance. As wise as this statement is, I still think it is well worth noting the financial similarities of 2q10 and 2q11. For starters, both periods shared headlines regarding the debt crisis in Greece, our Federal deficit, lower Treasury rates associated an economy hitting a soft spot, weak employment, and continued weakness in real estate. 2q10 brought the end of a significant real estate tax credit and problems with the BP oil spill. 2q11 brought an end to the Fed's 2nd quantitative easing program and lingering economic problems with the Japan earthquake/tsunami. For the stock market, both quarters experienced notable declines from recent peaks (see chart on previous page) while the bond market maintained an optimistic indicator in the form of a positive slope in the Treasury yield curve (chart also provided). In 2010, the negative sentiment built in 2q10 formed the basis for a strong equity market move in the second half of the year when the economy performed better and in a manner consistent with the yield curve indicator. Given these similarities, is it reasonable to expect the rest of 2011 to look like the second half of 2010?

Before addressing the question, it is a good idea to take a closer look at the quarter just ended. Overall equity market returns were meager and uneven over the past three months. Domestic large-cap stocks (S&P 500) ended the three-month period with only a .10% gain. In the more economically sensitive small-cap area, returns were negative with the Russell 2000 index finishing at -1.61%. International equities (MSCI EAFE) came in at +1.56%. The mentioned economic "soft-spot" along with higher oil prices and Greece are commonly cited as the primary reasons for the lackluster quarter. What seems to get little attention in this analysis is the fact that the economy continues to grow albeit at a slower rate. Another factor often ignored is that summertime usually brings a lower level of economic activity with projects and orders often affected by vacations or other distractions. It is my thought that this seasonal slowdown has been given exaggerated attention because of the sluggish nature of the recovery.

Short-term market predictions are difficult and subject to random developments. For the rest of this year and if there are no new developments of a major nature, I think the odds favor a positive outlook for the equity markets. This opinion is also felt for the longer term as well. Greece has implemented an austerity program and looks to receive European Union assistance. This action from the European Union probably sets precedence for other financially strapped countries as well. The current seasonal slowdown should swing to a seasonal uptick in the fall which is consistent with mentioned yield curve indicator. Also helping is a slowly recovering Japan and durable goods orders in the United States that are showing nice and sustainable trends. While the Fed has ended its quantitative easing (QE) program where it has been buying US Treasury debt, the Fed maintains that it will keep rates at a low level for an extended period of time. Furthermore, the Fed will continue to maintain a QE affect by retaining ownership of the Treasuries purchased under the program. Together, I think these factors outweigh numerous challenges that include our Federal deficit which appears to be heading to a boiling point with the extension of the debt ceiling needed by early August. Based on past behavior, it looks like we will have to put up with a great deal of political posturing and grandstanding prior to getting a deal done in the 11th hour. European banks, weak employment growth, energy prices, state deficits, and China's monetary tightening (that seeks to reduce inflation and other economic excesses) are other immediate challenges. Farther out, the elections of 2012 will gain market attention with taxes, spending, and regulatory policies likely to be affected in a significant way with the election outcome.

Lastly, I think it is interesting to note that the financial industry is starting to push back against the increased regulatory environment and making a strong case that such regulations are hurting the recovery. This was evident in the recent debit card "swipe fee" decision which could lead to more challenges that could affect the prospects of the financial sector. Such bravado is, I think, indicative of an industry that has largely recovered.

Thank you again for your interest and business with Timberline. It is a pleasure to be of service and please feel to call or email with any thoughts or questions.

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Timberline Investment Management, LLC