REPRINTED FROM JUNE 15, 2009

THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Large Cap Growth Investing

DAVID M. CARLSON is the Principal and Founder of Compass Capital Management, Inc. He has been in the investment field for nearly 30 years. His early career included working for a large pension fund, then as a retail broker, then as an institutional portfolio manager for a large, regional bank in Minneapolis. For the last 20 years he has been Principal/Founder of Compass. He finds that the best parts of working at Compass have been helping clients reach their investment goals and being part of the 11-member team at his firm. Mr. Carlson is a graduate of Luther College, Decorah, Iowa and his Master's and PhD degrees are from The University of Michigan, Ann Arbor.

SECTOR – GENERAL INVESTING

TWST: Would you start with an overview of Compass Capital Management and your investment philosophy there?

Mr. Carlson: We are in our 21st year, having started in August 1988. Charlie Kelley and I are the two founding principals at the firm. We, along with four other portfolio managers at Compass, manage about $350 million in assets. There are about 160 clients and our average client has roughly $2.2 million under management. We invest primarily in individual stocks and bonds and have a highly disciplined, concentrated, large cap growth stock discipline. For bonds, our focus is principal preservation and income, so we use high-quality, intermediate-term bonds only. The majority of our clients have balanced accounts, using a combination of stocks, bonds and cash in their portfolios.

TWST: Do your clients have customized portfolios? Is that a specialty of Compass?

Mr. Carlson: Yes, we spend a lot of time developing a written investment policy statement for each client portfolio. Some may have 100% stocks, some may have 100% municipal bonds, but there are many gradations in between of taxable bonds, tax-free bonds, common stocks. We work with the client to develop a clear and detailed investment policy statement that reflects their distinctive goals and guidelines. This statement becomes the first tab in the Compass booklets they receive each calendar quarter and we review that with them before we even look at holdings, performance and so forth. We are not financial planners. We work with many attorneys and CPAs to help us with tax and legal matters. Minneapolis/St. Paul is a very good center for top-notch legal and tax advice. We are happy to work with these professionals as members of the team.

TWST: What has it been like for Compass over the last few months with all the turmoil in the markets and the weakened economy? How have you been handling those situations?

Mr. Carlson: We are long-term investors, and these days, "buy and hold" gets a lot of bad press. I think it should, because long-term investing and "buy and hold" are very different concepts. Buy and hold can mean "buy and forget." This is certainly not what we do. There are six portfolio managers here and we meet weekly to review each of our holdings. If a company has become too expensive, if there is a major change in the company, or if we have found a better candidate, we are happy to sell that stock. In general, we'd love to hold these companies forever, but the real world prevents that in most cases. As far as the turmoil goes, we are a bit amused by the daily financial chatter and endless predictions. My observation is that human beings don't have a very good record of making accurate predictions. We'd rather look at the merchandise that's being repriced daily. If you look beneath the horror stories and what not, it's amazing the opportunities you can find — good quality securities that may be unfairly underpriced. We would rather use negative news to find good companies at low prices and hold them, we hope, forever.

HIGHLIGHTS

David M. Carlson says his firm has a highly disciplined, concentrated large cap growth stock process. In fixed income, he uses only high quality, intermediate-term bonds. He identifies companies whose earnings generally grow regardless of a vulnerable economy. They must have strong solid management teams, outstanding financial metrics, strong balance sheets and positive free cash flow. His portfolio currently has increased weightings in industrials and consumer staples, technology is at an even weighting, and there are conspicuous underweightings in financials and energy. Companies include: Illinois Tool Works (ITW); McDonald's (MCD); Sherwin-Williams (SHW); Kohl's (KSS).

TWST: How do you manage clients' expectations and concerns at times like these? Do you have close relationships with your clients?

Mr. Carlson: Yes, we do. It's a very high service kind of business we have. We meet with our clients frequently and communicate by phone and mail on a regular basis as well. It's another element of custom portfolio management. We can meet them quarterly if they wish to. Some will say, "That's one of the reasons I hired you — so we don't have to worry about it all the time." We are happy to meet with them as often or seldom as they wish. Since we've been in the business for a very long time, our track record gives clients some comfort. As I said, Compass has been doing this since 1988, and our results are real and reassuring.

TWST: What has it been like in the market turmoil for large cap growth stocks as a whole?

Mr. Carlson: As a whole, it's been a very mixed bag. As you know, if you had any financial stocks last year, that was a difficult spot to be. Energy stocks also corrected severely with oil dropping from a high around $140 a barrel down to $38 last year. We didn't hold energy during that cycle, and we didn't hold much in the way of financials. As a result, our performance was far better than the S&P 500 last year. As I mentioned, we have many balanced accounts that use high-quality bonds. In a 50% stock/50% taxable bond portfolio, we were down about 9% last year and that looks pretty good versus stock market returns in 2008.

"There are a number of industrial companies that look interesting to us. Illinois Tool Works is an example. We originally bought the stock in 1989. That gives you an idea of our holding period. Our original cost adjusted for splits is $4.76. At the present time, Illinois Tool Works is around $36. Even after all this market carnage, you can see the kind of long-term returns that are possible in a well-managed industrial company."

TWST: Have you shifted in emphasis in the portfolio construction to take these events into account?

Mr. Carlson: We continue to avoid financials. We hold one name, but it isn't in the line of fire from the government. It's a mutual fund company. Other than that, we are being very cautious in any industry that is heavily regulated that may be subject to new tax rules or anything that unpredictable policy changes would make investing in them a leap in the dark. We just look for high-quality growth companies when they are inexpensive and that leads us to a number of promising areas. We were on a bit of a buying spree in the fourth quarter last year and around the beginning of March this year when the market hit its low. We have found a number of interesting items.

You may be interested in knowing that we hold just 25 stocks in our core quality growth stock portfolios. When a name drifts down to a 3% position, we restore it to a 4% weighting. If a name races ahead and is overweighted at 5%, we trim it back to 4%. This prevents us from falling in love with a name and forces us to buy low/sell high.

1-Year Daily Chart of Illinois Tool Works

Chart provided by www.BigCharts.com

1-Year Daily Chart of Sherwin-Williams

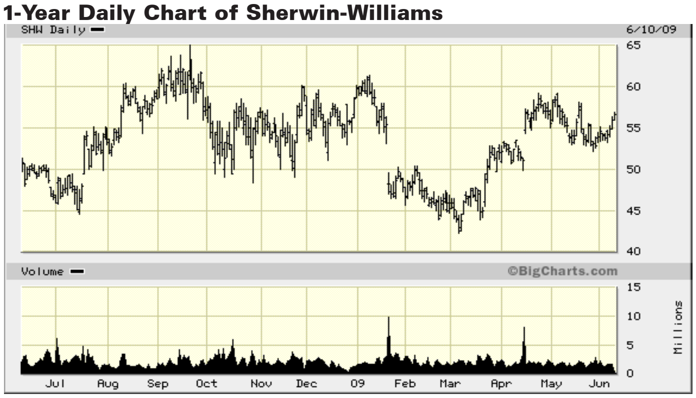

Chart provided by www.BigCharts.com

"Sherwin-Williams has been a wonderful, well-managed, long-term performer for us. This is an example of a company that's right at the heart of the downturn in the building cycle, but is so well managed the company seems to be coming through these times in relatively good shape. There is significant employee ownership in the company as well."

TWST: Do you have overweightings or perhaps just more exposure in certain areas?

Mr. Carlson: Yes, we have a 20% weighting in industrials and 20% weighting in consumer staples. Technology is still at a 16% weighting. We do have just one name in financials, as I said, and basic materials is 8%. What you see is a conspicuous lack of energy and an underweighting in financials.

TWST: What has been of interest to you in the industrials area?

Mr. Carlson: There are a number of industrial companies that look interesting to us. **Illinois Tool Works** (ITW) is an example. We originally bought the stock in 1989. That gives you an idea of our holding period. Our original cost adjusted for splits is $4.76. At the present time, **Illinois Tool Works** is around $36. Even after all this market carnage, you can see the kind of long-term returns that are possible in a well-managed industrial company.

Another growth dimension is the rising dividend stream provided by some of these companies. Ibbotson shows that much of the market's return has come from rising dividends. In these high-quality growth companies, seldom do you hear much interest in their dividends. However, in 2007, for example, our dividend-paying companies increased dividends by 22% on average that year. Last year, even when all the market carnage was occurring, our growth stocks that pay dividends increased them by over 16% on average, which is, I think, a pretty good indication that things must be relatively good on an operating basis in these companies.

TWST: Has yield become more important in a down market, particularly for your investors that need income?

Mr. Carlson: It really has. Foundations, endowments, retirement plans, retirees certainly are looking at where to get income. Now with short-term Treasuries yielding less than 1%, until you get out to about two or three years, it's tough to find attractive income from the Treasury market.

TWST: What valuation metrics are you looking for in a market where all valuations have gone down?

Mr. Carlson: Obviously, price/earnings ratios are of less value when earnings are under pressure, as they are presently. In some of our consumer staples companies, however, there is a much higher level of predictability. We do traditional valuation work using price/book value, price/sales, historical yields and many other parameters. We are also interested in knowing what the Street expects on a consensus basis so that we know where our bet is being placed. Many times, although Wall Street may be doing perfectly acceptable research, its time frame is so short that we have to ignore their buy/sell opinions. We like it when a major brokerage firm goes to a hold, by which they mean sell, and the stock gets pummeled. Many times that tells us we should look at the company and if all is well longer term, we may pick up the stock. Through computer screening, we know historically where a company has traded on average over the last five to 10 years and we also know where analysts are expecting earnings to be in the next one, two or even more years. These parameters help us in our valuation work.

TWST: In a more concentrated portfolio like yours, is the competence of management a qualitative factor in your selections?

Mr. Carlson: It is, absolutely. If there is a significant management change in the company, that's a trigger for us to consider selling the stock. We like to see companies with fine track records where managements have been in place for years. We also like it when there is significant insider stock ownership in the company.

TWST: Which companies in your portfolio have especially impressive management, some of your longer-term holdings?

Mr. Carlson: Illinois Tool Works is a perfectly good example of impressive management. **Sherwin-Williams** (SHW) has also been a wonderful, well-managed, long-term performer for us. This is an example of a company that's right at the heart of the downturn in the building cycle, but is so well managed the company seems to be coming through these times in relatively good shape. There is significant employee ownership in the company as well.

TWST: You mentioned that consumer staples forms a large percentage of your portfolio. What are your views on the consumer stocks at this time?

Mr. Carlson: The consumer is still the lion's share of the economy, so it only seems prudent to have a meaningful weighting in this sector. The issue is, what kind of consumer stocks? For example, **McDonald's** (MCD) is considered a consumer discretionary name. Nevertheless, we would regard it as a food distribution company. Moreover, nothing is as American as **McDonald's**, but two-thirds of their sales are outside the US and their food stores are individually tailored to the local culture. We want to find companies that have been able to maneuver through all kinds of conditions and persevered.

"We regard McDonald's as a food distribution company. Moreover, nothing is as American as McDonald's, but two-thirds of their sales are outside the US and their food stores are individually tailored to the local culture. We want to find companies that have been able to maneuver through all kinds of conditions and persevered."

1-Year Daily Chart of McDonald's

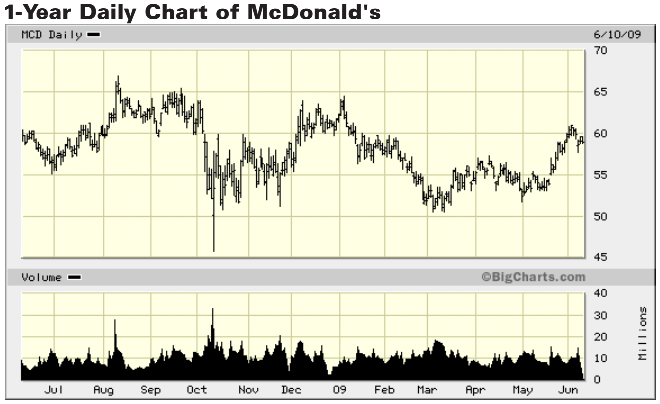

Chart provided by www.BigCharts.com

TWST: What is the discipline when it comes to triggering an exit from your portfolio?

Mr. Carlson: There are three reasons. One is significant overvaluation. Two is significant change in the company. They might make an acquisition outside their core business. That troubles us and we would be likely to sell it. Third, the most common reason is we simply found a better name that we would prefer to own on a growth and valuation basis. Every week, the six portfolio managers at Compass rank our stocks from 1 to 5; 1 is a table-pounding buy, 5 means ready to go out the door.

At all times we know which candidates are ready to be sold. The sell decision has to be unanimous. It's an interesting process because there are six of us. Nevertheless, it isn't difficult because we hire people who share similar investment methodologies. It's turned out to be fun to decide which stock to let go in order to make room for a new name.

"One of the star performers in the market is Kohl's. Kohl's is actually benefiting from troubles in traditional department stores (Mervyns for example), and they are going in and buying up retail space as these department stores go out of business."

Let me give you another name, a retailer. Many commentators have said retail is among the worst places to invest in this cycle. Nevertheless, one of the star performers in the market is **Kohl's** (KSS). Kohl's is actually benefiting from troubles in traditional department stores (Mervyns for example), and they are going in and buying up retail space as these department stores go out of business. In addition, **Kohl's** knows that many shoppers are tired of parking two blocks from the mall and devoting hours to finding something buried in the many shops inside. They would rather pull up to a **Kohl's** a few feet from the door, go inside where everything is in stock and reasonably priced, quickly pick up what they need and pay for it at the cashier conveniently located in the middle of the store. This is the kind of company we look for, a great company that has been mispriced and damaged because of real, but likely to be short-term disappointments.

TWST: Do you look at international stocks or companies that have international operations like McDonald's?

Mr. Carlson: Yes, that's been one of the most important elements of our system. Many of these large cap companies we buy are already developing a great deal of business overseas. For example, five companies in our portfolio have over 55% of their total sales outside the US. Another 50% of the portfolio consists of companies with between one-fourth and one-half of their total sales outside the US. These are well-capitalized companies that are able to generate cash internally for development globally.

TWST: What about the technology area, a traditional growth area that's not been doing too well?

Mr. Carlson: We have just four names in technology. One is really a payroll company. Obviously payrolls have been hit, but it has a very good yield, a decent growth rate, is very well managed, and generates lots of cash internally. Other than that, we have some other technology, large cap names you would recognize.

TWST: Are you usually fully invested or have you been getting a bigger cash position in recent months?

Mr. Carlson: Cash is always a passive element in the portfolio and does not result from market timing. It's based on the liquidity needs of the client. We are generally fully invested according to the investment policy statement. As I mentioned, some of our clients are 100% stocks, some have none. It all depends on the risk parameters, time horizon and other circumstances and needs of the client. We work within these guidelines and our computer modeling system is based on these ratios. For example, our average return last year in taxable bonds was over 10%. Obviously with stocks declining in these balanced accounts, the bond segment became overweighted. So in the fourth quarter, we trimmed some bonds and added to our stocks. The rebalancing process between stocks and bonds helps assure we will buy low and sell high.

TWST: What about the risk management aspect? How do you attempt to control risk at the portfolio level and at the individual security level?

Mr. Carlson: Generally, asset allocation is the most important aspect of risk management. Beyond this, our bonds are high-quality only, one to 10 years to maturity, rated AA or better, and non-callable. We want a great deal of control over our bonds because we think surprises there are almost invariably negative. When you think of what happened last year, many of the worst horror stories in the financial markets occurred with bonds. If we want to use our bonds for principal preservation, income and predictability, obviously we are going to do very careful work on that side.

"We ladder our bonds one to 10 years to maturity and shop very aggressively between sectors. There was a time in the first quarter this year for example, when tax-free municipals of very high quality actually yielded more than taxable Treasuries. One can shop and swap sectors and find bargains and add return on that basis."

1-Year Daily Chart of Kohl's

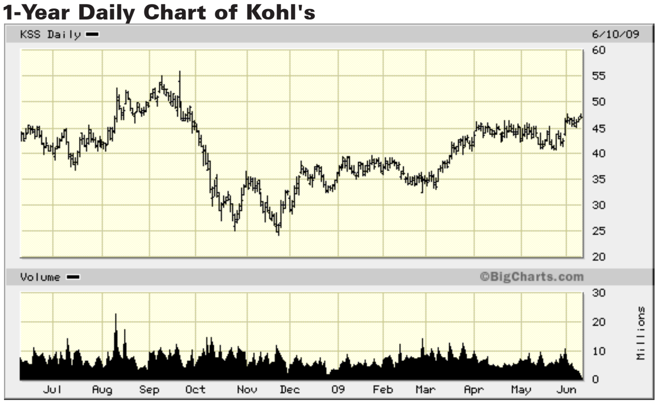

Chart provided by www.BigCharts.com

On the equity side, we attempt to limit risk through reasonable valuations, appealing dividends, broad diversification and by avoiding companies based on commodities or that are heavily regulated.

TWST: What is the policy at Compass toward fixed income these days?

Mr. Carlson: It's been sobering to see the backup in yields in Treasuries, for example. For example, the five-year Treasury at the end of last year was about 1.5%; it's now 2.4%. The 10-year Treasury was at 2.2% at the end of the year and now it's about 3.5%. The 30-year Treasury has gone from about 2.7% to about 4.4% in yield. We ladder our bonds one to 10 years to maturity and shop very aggressively between sectors. There was a time in the first quarter this year for example, when tax-free municipals of very high quality actually yielded more than taxable Treasuries. One can shop and swap sectors and find bargains and add return on that basis. We are very aware of what's happened to our government's balance sheet and we are concerned about inflation down the road. However, the laddering concept and shopping/swapping sectors mitigate that risk to some extent.

TWST: You mentioned the unanimity of your team in deciding to sell a stock. What features differentiate your investment approach at Compass from that at other peer firms?

Mr. Carlson: I think the 25 stock portfolio and equal weighting are certainly distinctions. The trimming and adding discipline of keeping a 4% position — trimming at 5% and adding at 3% — is another. We also avoid commodity-based sectors. At times we eat humble pie because we will lag when those sectors are momentarily in fashion. But the discipline has paid off very well for longer-term investors. Our results show that. We are also wary of the herd mentality of the Street, which makes us contrarians of a sort. We think of 1998-1999 with the dot-com cycle for example. We trailed somewhat in 1998-1999 as the market pushed more and more money into those highly overpriced names. However, in 2000, we outperformed the S&P by about 21 percentage points because we weren't involved in these names. Another distinction is that our track record spanning over 20 years follows a stock and bond discipline that has not changed. And two founding members of the team that built the record are still here. Most important, our clients work directly with the person actually making the buy/sell decisions in their portfolio. There are no 1-800 numbers to people who don't know you from Adam.

TWST: What is your outlook through 2009 into 2010 as far as your equities are concerned? Do you think there is light at the end of the tunnel?

Mr. Carlson: I am an optimist by nature and I know that a number of people who have absolutely stellar track records, such as Warren Buffett, are as well. I think so much of this boils down to time horizon. If you feel the heat of the quarterly performance drumbeat, then you are likely to be a nervous wreck at times like this.

On the other hand, if you see bargains all around, which we think we do, and also know this country has been through far worse problems than this and somehow come through the other side, you don't worry so much about it. We are well aware of the consensus that many have been looking for some kind of recovery in the third quarter, fourth quarter and a better year next year. I enjoy what the well-known economist John Kenneth Galbraith said some time ago. He said economists predict not because they know, but because they are asked. I am not an economist; that makes it even more hazardous to predict. I would much rather take a look at things that are priced around me now. When the news is negative, that usually signals a buying opportunity. When things seem rosy, it's often a good time to sell. I am very positive long term.

TWST: Are there any challenges ahead that investors should be wary of now?

Mr. Carlson: Yes. We think that you must do rigorous analysis to know what's going on currently. There are plenty of sources of good information about the current situation. I think where investors get into trouble is by adopting a scenario, investing according to it and then finding this scenario was wrong. I've been reminding our six portfolio managers here not to fall in love with any scenario. Just take one day at a time. Where are the opportunities today? They're all around us. We just have to look for them.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 6/5/09.

DAVID M. CARLSON
Compass Capital Management, Inc.
Suite 400
Baker Building
706 Second Avenue South
Minneapolis, MN 55402
(612) 338-4133