

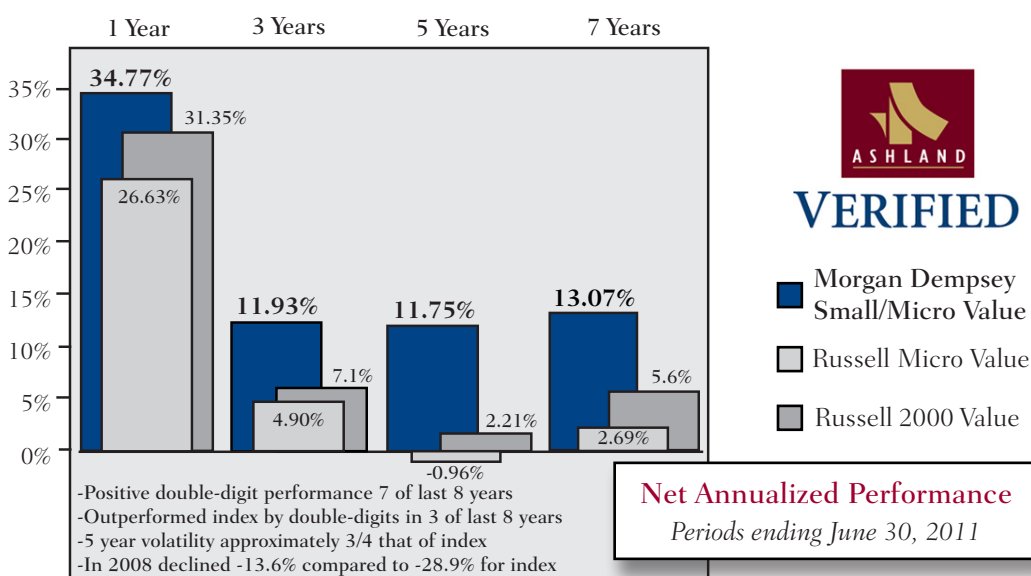
**Morgan Dempsey Small/Micro-Cap Value - Quarterly Commentary 2Q11**

**Economics from 30,000'**

The tepid economic expansion which followed the January 2008 – June 2009 recession marks its 26th month in August 2011. Normally economic reflation generates 8% to 9% in nominal GDP growth and 4% to 6% in real GDP growth. However this 2009-2011 cycle affords zero “margin-of-safety” in an economic commerce cushion. Since the summer of 2009 nominal and real GDP growth has tracked 3.1% to 5.5% and 0.4% to 3.8%, a significant deficit to normalized growth rates. The structural asset bubble and balance sheet focused economic recessions such as 2008-09 operate with a debt deleverage spiral at the core. This mutes the reflation cycle in magnitude and duration and generates recession stall periods every 2-3 years vs. the 10 months per decade since the Reagan Era (1980-1988)

A synopsis of the economic landscape in the U.S. as of the end of the 2nd Quarter, 2011:

- Non-financial debt of \$36,319,811,000,000.00 or 242.07% of U.S. GDP at \$15,003,817,000,000.00 is below the 335% levels of 2007 which identifies the debt deleverage cycle which fuels the weak consumption spending. Levels of consumer revolving credit card balances amount to \$798.3 billion in July 2011, a -15.24 % decline from the 2007 peak of \$941.8 billion.
- Interest rates price the cost of money available at or over forward horizons and the U.S. Treasury yield curve trades under a new AA+ credit at 0.24%-3.78%, a positive slope of 354 bp. The TIPS spread between 30 year U.S. Treasury bonds and inflation indexed tax free 30 year debt trades at 278 bp, a modest premium above the normal range of 240-260 bp and a rebound from the 24 bp spread from November 2008.
- On a National Income & Products Accounts (NIPA) basis of  $GDP = C + I + G + (I-X)$  where consumption spending (C) in the 2Q 2011 amounted to \$10,656 billion, or 71% GDP and exhibiting 3%-4% growth rate since 2009. Investment spending (I) is the key driver of economic growth, productivity and the reflection of a sentiment of confidence. Levels of (I) for the U.S. economy in 2010 amounted to \$1,795 billion, below the \$22,327 billion peak in 2006 and only a modest level higher at \$1,898 billion in 2011. Spending on factory plant structures amounted to \$433.3 billion in 2001, declined to \$309.1 billion in 2010 from a \$466.4 billion peak in 2008. Machinery and technology spending however expanded over the decade each year on a sequential basis from \$860.6 billion in 2001 to \$1,019.4 billion in 2010. The productivity spending is dwarfed by a decade of weak structures investment which must be reversed after an exodus of manufacturing to China.



Disclosures: See performance disclosure page for full compliance statement.

**Strategy Highlights**

- Fundamental - Bottom up research
- Concentrated in best ideas
- Emphasis on “Fortress Balance Sheets” (Limited Debt - Strong Free Cash Flow)
- Founder/Owner/Operator run companies
- Low Turnover

**Team Information**

**Brian G. Rafn -Principal/Portfolio Manager**  
25 years of experience in securities analysis, trading and portfolio management focusing primarily on small/micro-cap stocks. Brian holds degrees in Finance, Accounting and Economics and previously served as a family office Director of Research.

**Terence V. Pavlic, CFA**

24 years of experience including serving on the CFA Institute’s Board of Governors, managing a \$600M mutual fund and past president of the Milwaukee Investment Analysts Society.

**Account Information**

Management Fee: 1.10%  
Minimum Investment: \$1,000,000  
No lockup period or redemption restrictions

**Portfolio Information**  
**Supplemental Information**

Top 10 holdings as of 6/30/11

7.6% - Jos. A. Bank Clothiers, Inc.	JOSB
5.1% - Unit Corporation	UNT
4.9% - Gorman Rupp Co.	GRC
4.7% - Aptar Group, Inc.	ATR
4.4% - J&J Snack Foods Corp.	JJSF
3.7% - National Presto Ind.	NPK
3.2% - Granite Construction, Inc.	GVA
2.7% - Utah Medical Products, Inc.	UTMD
2.5% - Sturm, Ruger & Co., Inc.	RGR
2.3% - Ruddick Corporation	RDK

Total Number of Holdings: 74  
1 year turnover: 14.23%  
Median Market-Cap: \$563 million  
Weighted Average Market-Cap: \$1.2 billion

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- The worst imbalance which plagues the economy is the bureaucratic growth of liberal socialism exhibited by federal and state government expenditures and budget deficits. The charter of government intervention knows no boundary; wars, nationalized business, regulatory supervision, social entitlements, unfunded liability guarantees and foreign aid. Since September 2001, U.S. federal government spending and state spending expanded from \$1,846.4 billion and \$1,234.7 billion to \$3,035.9 billion and \$1,798.8 billion respectively.
- Inflation exhibits a visible acceleration in oil, agriculture (food) and commodity industrial metals. However, the broad economic measures illustrate a rollover from the 2004-2007 levels. The GDP deflator reported +2.4% to 2.7% levels of inflation for 2010-2011 vs. +2.1% to 3.3% for the 2001-2010 decade and -0.4% to +1.8% from the 2008-2009 recession. Peak inflation recorded in the 2005-2007 years exhibited +5.4% to 6.2% levels for PPI wholesale and +3.4% to 4.1% CPI consumer inflation. As of mid-2011, wholesale PPI and consumer CPI inflation decelerated to +2.4% levels and negative or deflation rates were reported for June 2011 of -0.4% and -0.2% rates.
- Labor force employment in the U.S. amongst civilian workers is 139,296,000 of the 153,889,000 civilian force or 9.1% unemployment, with underemployment, or search abandonment probably in the low to mid-teens.
- Capacity utilization reports 74.4% and 76.7% for manufacture and industry levels in 2011 below the 2007 peak of 79.2% and 81.0% but well above the stall speed levels for commerce.
- Money supply growth as measured by MZM.M2 and M1 aggregates exhibited higher growth rates of +9.3%, +6.8% and +13.0% in June of 2011 with MZM velocity declining to 1.43x from the 3.50x velocity turnover of the mid-1990s. The lesson exhibited is money stock growth alone, void of a match in velocity circulation or the money multiplier effect of fractional banking, does not catalyze economic growth.
- National charter and state charter commercial/thrift banks deposit required reserves as a % of various deposit liabilities ranging from 7% to 22%. Levels of bank required reserves amount to 77.5 billion as of June 30 with a total depository reserve of 1.6 trillion or 21.48x. Excess reserves available for loan underwriting amounting to 1.6 trillion which could support 5x or 7.94 trillion in loans, a level that is 53% of GDP. This pent-up capacity is the engine of future economic growth.

### **Quarter Perspective**

The capital markets, specifically the equity markets in the 2010's continue to focus on tangible and durable specie assets which reflect the emerging markets growth and demand for mining, farming or industrial fabrication. This focus has prompted gold bullion to trade as a currency which signals flight-to-safety and preservation of capital themes as well as a focus on commodity inflation in general. The 2nd Quarter of 2011 marked the high water index peaks in April, followed by deterioration in price levels which by mid Q3 had destroyed \$3.12 trillion in paper wealth from common

stock holdings. The quarter illuminated the capital preservation of "fortress balance sheets" and a focus on our company's cash liquidity and debt solvency. The bulk of the quarter matched or paralleled the cool and wet Wisconsin spring weather yielding "soggy" internal rates of return.

As we have a greater visibility of earnings power from the 2Q 2011, our business holdings and dialogue with senior managers indicate a backlog of orders and expanding sales, coupled with robust bids/quotes activity. Those same managers reported they would routinely return home to the evening news only to be inundated by the media's despondent tone, creating a curious uncertainty as it countered their own current experience.

The Morgan Dempsey Small/Micro Cap Value Institutional strategy ended the quarter -3.41 net of fees and positive +7.04% year to date.

On an issue specific basis the performance derby for the quarter exhibited a shock absorber or braking function which in the bear cycle means losing the least amount of capital. The Wall Street rhetoric voiced a death of consumer staples in April, which was ignored and have structured in a 13% - 14% insurance policy of stability. The defensive nature of the quarter yielded some positive net gainers: Aptar Group Inc. (+4.4%), BalChem Corporation (+17.4%), Atrion Inc. (+13.4%), Cabela's Inc. (+8.6%), Carbo-Ceramics Inc. (+15.5%), merit Medical Systems Inc. (+19.7%), Sun Hydraulics Corporation (+6.2%), ZEP Corporation (+8.56%), and J&J Snack Foods Inc. (+5.9%). The quarter featured the M&A deal of Herley Industries acquired by Kratos Defense at \$19.00, a "buy under" when the interim chairman and CEO opted for a liquid exit instead of the organic rebuild of the business. We voted no on the deal and waited for Gabelli & Co, the largest shareholder, to force a higher premium toward our \$24.55 intrinsic value. The quarter's defensive posture featured 20 of 74 stocks exhibiting positive quarterly capital gains coerced from package/containers, eggs, pretzels, soap & detergent, grocery marts, oil/gas tubular pipes, hydraulic cartridges and single use disposable medical devices. The portfolio liquidated United Fire & Casualty Company Inc. after two 500 year Mississippi river floods and purchased Johnson Outdoors Inc. (JOUT). Johnson Outdoors Inc. is a niche sporting goods manufacture that specializes in products holding a #1 or #2 market share such as Scuba Pro, Mitchell reels, Old Towne Canoes, and Minnekota trolling motors. We initiated buys at \$14.30, trading under 10x EPS and a 30% premium to tangible book value. Johnson Outdoors Inc. is a 5th generation founder/owner/operator company run and largely owned by the Johnson family of Racine Wisconsin who privately own S.C. Johnson & Sons Inc.

SMALL/MICRO-CAP VALUE INSTITUTIONAL COMPOSITE - ANNUAL DISCLOSURE PRESENTATION

Year End	Total Firm Assets (millions)	Composite Assets (USD) (millions)	Number of Accounts	% of Non-Fee-Paying	Annual Performance Results Composite		Russell 2000 Value Index	Composite Dispersion
					Gross	Net		
6/30/11 YTD	274	109	14	0%	7.71%	7.13%	3.77%	N.A.
2010	213	49	10	0%	26.86%	25.68%	24.51%	.49%
2009	173	5	8	0%	21.96%	20.83%	20.58%	.33%
2008	141	3	5	0%	-12.75%	-13.62%	-28.92%	N.A.
2007	188	4	5	0%	11.74%	10.67%	-9.78%	N.A.
2006	190	3	4	0%	19.74%	18.61%	23.48%	N.A.
2005	69	3	4	0%	16.60%	15.50%	4.71%	N.A.
2004	73	2	4	0%	23.57%	22.40%	22.25%	N.A.
2003	137	.4	1	100%	32.98%	31.73%	46.03%	N.A.

N.A. -Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Morgan Dempsey Capital Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Morgan Dempsey has been independently verified for the periods June 30, 2000 through March 31, 2011.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Micro Cap Value Institutional composite has been examined for the periods January 1, 2004 through March 31, 2011. The verification and performance examination reports are available upon request.

Small/Micro-Cap Value Institutional Composite was created June 30, 2010 and contains fully discretionary Small/Micro-Capitalization Value, US domiciled, long only equity, commission based accounts and for comparison purposes is measured against the Russell 2000 Value Index. The minimum account size for this composite is \$100,000. The firm maintains a complete list and description of composites, which is available upon request.

Morgan Dempsey Capital Management, LLC is an independent investment management and advisory firm registered under the Investment Advisers Act of 1940. MDCM was established in 1994. The assets reflected in this investment performance begin with the 3rd Quarter 2002. The number of portfolios in the composite is as of yearend.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Results for Q4 2002 and Calendar year 2003 were from one account managed and researched exclusively by Brian Rafn at a previous investment advisory firm. Beginning January 1, 2010, composite policy requires the creation of a temporary portfolio for a client initiated significant cash flow of at least 10% of portfolio assets. The creation of such a temporary account occurs on the date in which the significant cash flow occurs and the temporary account is combined with the corresponding composite account at the month end after the cash flow is fully invested. The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using MDCM's maximum Small/Micro-Cap Value annual management fee of 1.1%, equally applied on a monthly basis. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The investment management fee schedule for the Small/Micro Cap Value composite are as follows: first 25 million +1.1%, next 25 million = 1.0%, next 30 million = 0.95 bp, above 80 million = 0.85. Actual investment advisory fees incurred by clients may vary.

Small and Micro-Cap stocks may be subject to a higher degree of risk than more established company securities. Small and Micro-Cap stocks may be less liquid which can potentially increase trading costs. The composition and market volatility of the Russell 2000 Value, Russell 2000 and Russell Micro-cap Value, which are unmanaged market value-weighted indices, and the composition and volatility of the portfolios managed by MDCM are materially different.

Past performance does not guarantee future results. A client's investment return may be lower or higher than the performance shown above. Clients may suffer an investment loss.

The information herein is for informational use only. Under no circumstances does this information represent a recommendation to buy or sell securities. Information contained herein should not be construed as a solicitation or offer of any services in a jurisdiction where Morgan Dempsey Capital Management, LLC is not registered to do business or does not qualify for an exemption or exclusion from registration requirements.

There can be no assurance that MDCM's future recommendations and account performance results will be favorable, or that losses will not occur in any client's account. The information contained herein is not a guarantee, or warranty by Morgan Dempsey Capital Management, LLC, nor its employees for any loss you may incur as result of the given information.

Unless otherwise noted, performance results discussed in company communications and advertisements are net of fees and taken from our performance composite for the time period specified. Further detailed disclosure information is contained in our Form ADV Part IIA which is available upon request.

Factors such as the size and performance of specific securities positions in accounts, the length of time certain positions are held, the timing of purchases and sales during the reporting period, client objectives, cyclical securities price trends, favorable and unfavorable news pertaining to securities, market trends and other factors all influence performance results materially. For these reasons, actual client account performance for any style would only match MDCM's total performance by coincidence. Upon request MDCM will provide a complete list of all recommendations made within the past year.

Due to an error, the number of accounts for 2004 have been updated from 3 to 4 and for 3/31/2011 have been updated from 13 to 10; the 3 accounts reported in the composite as of 3/31 were subsequently added to the composite on 4/1/2011, one day later.

The data used for this report was obtained from sources deemed reliable and then organized by the staff at MDCM. Performance calculations were prepared using standard industry software and were not audited by any third party. Some information provided on MDCM's website or in company communications reflects opinions, and as such are not facts. These opinions are subject to change with changes in economic conditions and new information. Therefore, this information should not be used as a basis for an investment decision.

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