PROFESSIONAL FINANCIAL MANAGEMENT, INC.

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Dear Client,

Hello and hope your new year is off to a good start. Enclosed are your fourth quarter and 2011 annual reports, our privacy policy, and, should it apply, your 2011 capital gains and IRA withdrawal reports. The capital gains and IRA withdrawal reports should be provided to your tax preparer.

As we have often said, we believe that the majority of you as clients have a good grasp on what long-term investing entails. However, the streak of events experienced in the latter half of 2011 may have created some questions with regard to your investment strategy – perfectly natural reactions. So as we begin 2012 with subdued markets and signs of an economic recovery that continues to take hold, now is as good a time as any to provide you a few new year “investment resolutions”, or principles to help re-enforce a positive outlook and keep your focus on the ultimate goal of your portfolio…long-term financial security. Before we begin though, here is a quick re-cap of how markets around the world fared in 2011.

2011Market/investment Re-cap

2011 reminded us to hope for the best, prepare for the worst, and be thankful when reality does not match our fears. What started as a very bullish outlook for the year turned pessimistic in the wake of natural disaster (earthquake and tsunami in Japan), political unrest in the Middle East, rising oil prices, the US credit downgrade, threat of another global recession, and an escalating debt crisis in Europe. These concerns created high levels of volatility and renewed concerns of a recession. The year ended with the S&P 500 slightly up 2.11%, but one of only three countries with positive equity returns for the year (the others being Ireland and New Zealand). Overall, International developed and emerging markets struggled. The MSCI World ex USA Index had a -12.2% return and the MSCI Emerging Markets Index returned -18.4% for the year. Along the size dimension, large caps outperformed small caps in all markets. Value stocks underperformed growth stocks everywhere with the exception of emerging markets where they mostly outperformed.

2012 Investor Resolutions

We begin our discussion with the notion to: Embrace Volatility. What, you say?! We know that no one likes volatility and when it is tied to a drop in market returns it becomes even more unsettling. A recent study documented in one of our Journals took price change and standard deviation data on the S&P 500 from 1928 – 2011, to research volatility and its affect on the market returns (study performed by C. Thomas Howard Ph.D., Professor Emeritus, Daniels School of Business at the University of Denver and Craig T. Callahan, President of ICON Advisers, Inc.). While the study validates the fear that increased volatility results in negative returns, its major finding is what happens on the heels of such periods and why it is important to grit out the uneasy times. The data showed, conclusively, that when volatility subsides, higher returns can be expected. To quote the study, “High volatility may be accompanied by low and even negative returns, but it is also predictive of lower future volatility and above-average returns.” Further, it is believed that all of this activity is directly related to investor behavior - investors who succumb to their emotions during highly volatile periods sell out, driving prices and returns down. Later, when these investors quit selling or get back into the market, higher returns result. However, one can only take advantage of these movements if they are more rational than their peers and stay put. Letting emotion drive investment decision hurts both short and long-term performance and is detrimental to achieving the best long-term results.

Our second resolution: Focus on Long-term and not short-term results. Focusing on one, two or even three year returns is no way to judge the effectiveness of your retirement portfolio strategy. As humans, we are wired to focus on the short-term and the media and financial services industry encourage this behavior in us for their benefit, developing products and strategies that create dollars for them and lackluster performance for the investor. As well, a short-term focus is what many studies have shown results in below market returns for the average investor over long time periods. DFA executive Jim Parker wrote in a recent article, “The result of this short-term mindset is that investors end up following the herd and seeking safety when opportunities are plentiful and seeking risk when opportunities are few.” In short, maintain a level of discipline amid the noise.

Closely tied to both previous points is our third resolution: Don’t look in the rearview mirror. Yes, equity values have been a casualty of the recent market volatility, but as we discussed earlier, eventually the pendulum swings the other way. Don’t make the mistake of thinking that a move to safer investments at this point will protect you now or even if we continue to experience volatility in the near term. Think of it this way - investing in cash instruments like a money market account or 90 day Treasuries will yield about .02%....if these rates persist it will take over 3500 years to double your money! Remember that things change – top asset classes from the previous year can be on the bottom the next….no one knows what will happen from one year to the next. From where we stand now, stocks are the best looking asset class going forward and probably will be for the next decade or so. Burton Malkiel, respected economist and author echoes this is a recent Wall Street Journal Article saying that, “…US stocks should produce returns of about 7%, five points higher than the yield on safe bonds…..Stocks were losers to bonds in 2011. But don’t invest with a rear view mirror.” Building financial security requires taking educated risks and a well allocated and diversified strategy keeps investors in position to reap the benefits… as long as you don’t look back.

While our feeling is that things are moving forward, the pace will continue to be slow, and turbulent times lie ahead, with fears of US and European debt likely to dominate the headlines for some time to come. Negative news can dominate the headlines at any time, and new challenges can present themselves at any second…these are things we can’t control. However, things we can control, like understanding how volatility benefits us, keeping a long-term discipline, and sticking with an allocated/diversified approach, re-enforce the belief we are doing the right things to make us successful investors over the long haul.

With warm regards,

Doug Babcock

Bob Frey