945 Technology Blvd., Suite #102, Bozeman, MT 59718

April 25, 2012

Dear Client,

We hope this letter finds you well and enjoying what spring has to offer. Enclosed is your first quarter performance report. As we move into the second quarter of 2013 we are writing to summarize market developments since the start of the year and to provide some perspective on market returns as well as thoughts on the idea of market valuation and corrections. First though, a quick re-cap of the first quarter of 2013.

THE FIRST QUARTER IN REVIEW

Markets got off to a strong start aided by the passage of legislation by Congress in early January to avoid the "Fiscal Cliff" and potential of sending the US economy back into recession. They continued to show strength finishing the quarter surpassing original highs set back in October of 2007. European concerns threatened to put the brakes on markets (as they have in previous years) with the banking crisis in Cyprus and continued issues in Greece, Spain, and troubled election results in Italy. Investors, however, seemed to shirk the need for short-term reaction to non-market events as confidence in both domestic and international economies appeared to take hold. Here's how first quarter performance looked:

	US	International	Fixed Income
1/01/2013 to 3/31/2013	11.23%	5.13%	-.12%

Sources: Wilshire, MSCI, Barclay's Capital - US Dollars

MARKET RETURNS AND PORTFOLIO RETURNS: SOME PERSPECTIVE

Admittedly, providing market return data and performance information can be a double edge sword. On one hand, it provides clients a point of reference for their own portfolio. On the other hand, it can place too much emphasis on short-term returns, causing clients to "lose sight of the forest through the trees". Focusing on what occurred last quarter, last year, three ago, etc., can divert attention from the real concern, investment time horizon, which may be 15, 30, or even 40 years from today. As well, sometimes returns don't tell the whole story. While PFM's investment strategy is intended to achieve better than market returns over a clients investment lifetime, it needs to be understood that, for many valid reasons, there will be periods of underperformance.

Past examples of trailing performance have been attributed to the relative underperformance of Value and Small Cap stocks relative to Growth and Large cap stocks – sometimes there will be periods of underperformance that we have no way to predict and just need to ride through. A more recent example of this concerns the bond exposure in your portfolio. As shared previously, it is our belief at Professional Financial Management that bonds serve to provide a dependable source of stable withdrawals during stock market declines, while adding stability to a portfolio - any desire to increase risk and return is better achieved through the stock or equity portion of the portfolio.

However, many investors don't understand the risk associated with bonds, and this can be seen in their continued quest to seek yield, either by increasing the maturity (term/ interest rate risk) or decreasing

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credit quality (credit risk) of their bond holdings. While this may work to increase short-term returns, it could result in long-term losses that may never be recovered (if rates rise, longer term bonds lose value and the only way to recover this is if rates go back down – a highly unlikely scenario).

So what does this mean? The current bond strategy accomplishes our strategic goal (mentioned above) but presents a problem from a performance perspective.   We use the Barclay's Aggregate Bond Index to track performance. However, while this is an applicable measure of bond performance in normal times, the risk in this benchmark index now is too high. Looking forward, we expect client portfolios to trail the benchmark due to our current bond exposure. However, outperforming the benchmark can't be the sole mission with regard to your portfolio, especially if the benchmark contains bond positions that are far riskier than we feel are appropriate. Understanding risk and return elements and how they play into your overall investment objectives and strategy provides for a better long-term investment experience than just trying to achieve the best short-term rate of return.

OVERVALUED MARKET HEADED FOR CORRECTION?

The question for long-term investors should not be so much about valuation and potential market correction as it should be about the relevance of the market's valuation to their situation. Market valuation information can be helpful to gauge potential future market returns for investment planning purposes. For example, an overvalued market may mean lower future return expectations, and an investor who is saving for retirement may need to save more money if they are to reach their retirement goal. Where it has no relevance to a long-term investor is if the information is used to try and "time the market" with the intent to sell and "capture gain" – this is a dangerous game. Thinking in these terms is akin to market timing and presents investors with two problems: 1.) where do you invest the "profits", and 2.) when is the right time to get back in to the market?

To answer the first question, even if you believe markets are overvalued, stocks still represent a better investment opportunity than bonds (or any other asset class, including cash, for that matter) for the foreseeable future. If the money is not needed for short-term use, a move of this kind will only hurt your long-term potential. To answer the second question, very few have ever shown the ability to be right twice. One of the most skilled asset managers of our time, former Fidelity Magellan fund manager, Peter Lynch, himself said, **"Far more money has been lost by investors preparing for corrections or trying to anticipate corrections than has been lost in the corrections themselves."**

We have no way of predicting when markets will correct – recent research information from Dimensional Fund Advisors shows there is no correlation between markets that reach new highs and corrections. The point here: maintaining a strategy and disciplined allocation is as important in good times as it is in bad. While the media continues to focus on short-term potential "outcomes", we all know these don't serve as a basis for long-term investment decisions.   For all these reasons, we continue to promote the benefits of long-term strategy and prudent asset allocation as these factors are what really determine an investor's ability to achieve the best long-term investment results.

As always, thank-you for the opportunity to serve as your financial advisor.

Sincerely,

Doug Babcock, CFP®   Bob Frey, CFP®