PROFESSIONAL FINANCIAL MANAGEMENT, INC.
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Dear Client,

Greetings to you in this New Year! Enclosed, please find your 4th Quarter and 2014 Annual performance reports and our 2015 privacy policy. Please note that all tax information (if it applies to your account) will be sent in a separate mailing.

2014 was the year of many things, a few of the most notable being "misguided" predictions (go figure), return of market volatility, concern over market valuations, the Ebola scare, and the usual array of domestic and international political and economic concerns. A "bumpy ride" as one review we read touted, gave investors the classic "good news/bad news" scenario. In this letter, we will look back at what transpired in the markets in 2014, and finish with an explanation as to how this affected your portfolio and what we need to focus on as we move forward through this year and beyond.

2014 ECONOMIC AND MARKET REVIEW

As we have mentioned often in our correspondence, no one can predict with confidence what will happen with the economy or financial markets. This was again revealed to us in 2014. As Jason Zweig summarized recently in his Wall Street Journal Intelligent Investor column, "experts" predicted rates would rise, Oil prices would rise, the stock market tumble in September/October would result in a much anticipated market correction, and the active stock pickers would finally outperform the market. Results could not have been further from the truth, and in reality, US equity markets ended higher, bond rates actually went lower, Oil prices dropped nearly 50%, and active stockers put another nail in their coffin, drastically underperforming the markets and having their worst year in over three decades. As will be emphasized later, having a laid out plan or investments strategy again proved to be a sound approach for our clients.

The US equity markets, especially US Large Cap Stocks and REITS, dominated world returns in 2014. The S&P 500 Index rose 13.69% (including reinvested dividends), marking the third straight year in which the benchmark has returned more than 10%. The Dow closed at a record high on 38 calendar days, while the S&P 500 had 53 record closes. Real estate securities had a banner year: The Dow Jones US Select REIT Index returned 32.00%, and the S&P Global ex US REIT Index returned 10.94%. The non-US markets followed a much different track: All major indices logged negative performance for the year (in USD). The MSCI EAFE Index had a -4.90% return and the MSCI Emerging Markets Index a -2.19% return (net dividends, in USD). The dollar's strong performance relative to major regional currencies contributed significantly to the lower returns for US investors.

Government bond yields fell across major markets, including the US, where many expected higher rates in response to improving economic growth and an eventual rate increase due to the end of quantitative easing by the Federal Reserve. The yield on the 10-year Treasury note declined to 2.17% by year-end, down from 3.03% in 2013, with lower prices boosting its return to over 4.0% for the year. The Barclays US Government Bond Index returned 4.92%. World government bonds had

slightly positive returns: The Citigroup World Government Bond 1–5 Year Index (hedged) returned 1.90% (all market summary information provided by DFA, Bryan Harris).

HOW THIS RELATES TO YOUR PORTFOLIO AND OVERALL INVESTMENT STRATEGY

Your 2014 performance illustrates a very important point about your investment strategy, one that you must understand and appreciate. While we won't "sugar coat" your portfolio results, a review of how your strategy works is in order to better understand your portfolio results for the current year – your portfolio did not do horribly, but you need to understand why it did not do as well as the broad market for comparative purposes.

Your strategy is not only well diversified portfolio with weighting to domestic and foreign stock and bond asset classes, but is also unique in that is structured to benefit from the research that putting additional emphasis on certain "sub" asset classes (specifically domestic/international value and small capitalization stocks) can boost portfolio performance when compared to the general market over long time periods. Now, to achieve this, we expect to experience some performance variance when compared to general market performance, and we accept and encourage this as your advisor, so that we can have the opportunity to achieve better than market results over the long haul.

The market research we have shared with you, combined with your actual investment experience, has shown that your portfolio returns can vary from the benchmark in your Investment Policy Statement, both to the high side and to the low side. Our value and small cap oriented stock strategy usually *but not always* outperforms the broad stock markets. 2014 proved to be one of those "but not always" years.

While 2014 proved to be a good year for the broad markets (the good news as mentioned earlier), the bad news was that all the chaos and worry that returned to the markets turned the table. For the past couple of years, our clients have seen a positive variance in relation to the market benchmark - coming through the 2008 downturn, value and small cap stocks outperformed mightily and this was reflected in your portfolio performance. As you recall, we cautioned that this trend could flip flop, and in 2014 it did, with value and small cap stocks underperforming their Large Cap and Growth counterparts.

Though we have not seen this recently, we have seen it before. 2014, similar to 1996-99 and 2008-early 2009, was a very difficult year for the DFA stock funds. For the past year, almost all small cap and value funds (with the exception of the DFA Emerging Markets Small Cap Portfolio) significantly underperformed the broad stock market averages, both domestically and internationally. Further, most DFA funds (being relatively "deeper" or having greater exposure in the value and small cap dimensions relative to their peers) also underperformed their respective asset classes (as we cover with you in your annual portfolio and as a quick review, what this means is that when value and small do well, DFA funds will do better than their peers – when value and small cap funds do poorly, they will underperform their peers). With this information in mind, here is the "bad news" for the past year:

DFA Fund	Annual Performance vs. Broad Market in 2014	Percentile Standing in Asset Class in 2014
US Large Cap Value	-3.62	60%
US Microcap	-10.77	68%
US Small Cap Value	-10.21	58%
International Large Cap Value	-2.09	59%
International Small Company	-1.40	64%
International Small Cap Value	-.09	32%
Emerging Markets Value	-2.23	68%
Emerging Markets Small Cap	+5.19	6%

NOTES:

1. US funds are compared to the S&P 500 Index, International Funds are compared to the MSCI EAFE Index (in US dollars), and emerging market funds are compared to the MSCI Emerging Markets Index (in US dollars).
2. Percentile Standing is from Morningstar for Mutual Funds, with 1 being the best standing and 100 being the worst.

Again, as we have repeatedly stressed, although the DFA academically proven strategy almost invariably provides superior results *long term*, there will be short to medium length periods, such as 2014, that value and small cap weighted strategies simply don't work as expected, and no one can reliably predict when those discouraging periods may happen. Similar to all stock investing (when frequent, unpredictable, but relatively short severe market declines occur) the investor must simply "stay the course" through turbulent times to realize the ultimate rewards.

You must keep this in perspective. Yes, these discouraging 2014 results may dampen your relative performance against the broad market benchmarks over the next three to five years. However, your time horizon is assuredly far longer than one to five years, and those periods of DFA funds significantly *outperforming* the overall stock markets *far outweigh* the disappointing periods such as 2014. Looking back 15 years (for those DFA funds that have been in existence over that entire period), The DFA funds have all *greatly* outperformed the broad markets over the entire period, and most of them stand quite respectably in their respective asset classes. Here is the 15 year data, ending Dec. 31, 2014 (which includes the dismal 2014 and 2008-early 2009 results):

DFA Fund	Annual Performance vs. Broad Market over last 15 years	Percentile Standing in Asset Class over last 15 years
US Large Cap Value	+4.20	8%
US Microcap	+5.68	38%
US Small Cap Value	+7.28	24%
International Large Cap Value	+3.29	10%
International Small Company	+6.01	12%
International Small Cap Value	+7.78	1%
Emerging Markets Value	+1.97	14%
Emerging Markets Small Cap	+2.75	8%

Looking back over *almost any* 15 year historical period, the results are somewhat similar. These significant annual return advantages, measured over long periods (the only periods that matter!), can provide significantly more wealth than almost all other investors or equity investment strategies out there.

One last point here – while this discussion has focused on equity performance, we can't fail to mention the fixed income portion of your portfolio. With a domestic strategy here that takes considerably less risk than the overall market, the yield on this portion of your portfolio has also played a role in pulling down returns over the short-term when compared to the composite benchmark. In general our stance simply is that the bond portion of your portfolio is a "safe haven", and maintaining a conservative exposure at this time allows access to cash for spending/emergency needs in the event of a market downturn. In return for diminished interest rate risk, we are willing to accept lower yields. Yes, this does impact overall portfolio performance but we feel the reasoning is justified. At this point, we don't feel that stretching for additional yield justifies the additional risk that is taken on. As the rate environment changes and other assets classes (like TIPS) become more attractive, we will be in contact with you.

LOOKING AHEAD – 2015 AND BEYOND

While we have covered a great deal of information here, we want to leave you with these few time tested thoughts as we move into another (and many more!) event filled years. Though these themes may sound tired, continual re-enforcement of sound investment practices like these help ease our temptations to stray and keep us grounded when things don't appear so rosy. These are:

- **Stay focused and disciplined**. As we wrote about at the beginning of the letter, market prognosticators are rarely accurate (if ever) and can have us chasing our tails. Yes, market valuations are high and both the stock and bond markets are expensive. However, trying to time out of these asset classes to gain an advantage has never proven to work. As well, don't let volatility concern you – it is a normal part of the investment process and in most respects, healthy. The best one can do is to have and maintain a disciplined and academically based strategy that is effective in most all market conditions, allowing for the best long-term results.
- **Diversification works**. As we've experienced recently, US asset classes dominated their International counterparts in recent years. Again, keep a long-term perspective here – research supports that over ten and twenty year periods, geographic and asset class diversification have proven beneficial for returns and for risk management;
- **Expect variance from benchmark or market performance**. As we have exhaustively explained, your strategy is designed to accept variance (both positive and negative), and without it, one would not have the potential to outperform markets long-term.

Rest assured that, despite short periods where markets do not behave as expected, we continue to carefully invest your money (and our own!) in accordance with the best research available. Adhering to a disciplined strategy through thick and thin has always rewarded patient investors, and we are here to help keep you on course.

We hope you have found this review helpful. Thank-you for the opportunity to serve as your financial advisor - we look forward to assisting you in the accomplishment of your current and long-term goals.

Sincerely,

Doug Babcock, CFP®

Bob Frey, MS, CFP®