PROFESSIONAL FINANCIAL MANAGEMENT, INC.
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Dear Client,

Greetings! Enclosed, please find your 2nd Quarter performance report.

World economic concerns along with continued debate about U.S. market valuations and the Fed's coming rate increase are grabbing headlines and creating investor concerns. With multiple events and issues clouding the economic landscape, we will discuss the most prominent, providing some perspective and insight on big picture implications and the impact investors may see as a result. First, however, is a quick review of how world markets fared this last quarter and for the first six months of 2015.

Second Quarter 2015 in Review

Markets continued to trudge forward in the second quarter despite pockets of volatility. In terms of US dollars, emerging market stocks outperformed International Developed Markets and US markets for the quarter. The Value premium was evident in emerging market stocks but did not materialize in US or International developed markets. The small cap premium was evident across emerging, international developed and US markets.

Positive equity returns for the quarter lifted year-to-date returns through June 30th, and we continue to see the "reversal of trends" in asset class performance noted in our Q1 letter, as International Developed and emerging market stocks continued to perform better than US stocks, despite concerns in Greece and China (discussed below). Again, this change in market leadership emphasizes the importance of maintaining a diversified portfolio and resisting the temptation to abandon asset classes that previously lagged behind! A summary of QTD and YTD performance is as follows:

	US Stock Mkt.	International Dev. Mkts	Emerging Mkts	Global Real Est.	US Bond Mkt.	Global Bond–ex US
Q2 '15	+.14%	+.48%	+.69%	-7.90%	-1.68%	-3.19%
YTD '15	+1.94%	+4.34%	2.95%	-4.56%	-.10%	-1.02%

Source: Russell, MSCI, Barclays and Citigroup

If you are interested in additional information, we are adding a new reference resource. While we will continue to provide you this cursory re-cap of market activity, a power point presentation providing a more detailed breakdown is being posted to our web-site (www.profinancialmgmt.com) - click on the "News" tab to view this and archived quarterly messages for additional reference.

World economic concerns

Macroeconomic events in Greece and China have stirred up markets in recent weeks. The issue in Greece is really nothing new, just a newer version. This situation will continue to fade in and out of headlines creating interim volatility, despite the current agreement on a bailout package. The issue here is not Greece itself - the country has a very small economy that accounts for roughly 1.8% of the European economy. Their total debt, while large in monetary terms, represents less than a quarter percent of the world debt markets, the majority of which is owed by European governments. **For these reasons, their effect on individual investor portfolios is negligible.**

The real concern with Greece will be their ultimate decision to stay or exit the Eurozone and the affect this will have on the Euro and on the global financial system as a whole – what happens on all fronts here is uncertain. However, the bright spot in all this is that the European economy is much more able to absorb adversity today than when this issue first came up 5+ years ago, with a strengthening economic recovery, abundant central bank stimulus, and investment markets that are among the top performers year-to-date (something most investors would never have thought!)

China clearly presents a larger economic concern, the most recent of which is the extreme market volatility seen in Chinese mainland markets. While no one knows what the current volatility means, the Chinese financial markets, in general, are really not the lead concern. Chinese markets are still in their infancy, with China still classified as an emerging market. They are tightly controlled, have very limited foreign access, and have an extremely limited participation (by percentage) from even their own population (who as of late have leveraged heavily in a speculative frenzy). All these factors contribute to markets that have been historically volatile, with soaring gains followed by massive sell-offs. The most surprising number, however, is that they only account for 2.6% of global market cap – **this, combined with limited access means that most investors have very little direct exposure to Chinese markets in their portfolios** (as Russell Investments summed it up, Big News but small part of a diversified portfolio).

The real issue with China is on the economic front. Unprecedented double digit growth for years has slowed abruptly to the mid-single digits, putting them in unfamiliar territory. While the slower growth could present larger implications for the global economy, these are unknown and are yet to be determined - this situation will continue to play out and be watched closely.

US Market Valuations and Fed tightening concerns
We've discussed market valuations as related to market corrections in previous communications and want to revisit due to the heightened concern as we are now in the sixth year of a bull market. A popular measurement of stock market valuation is Robert Shiller's (Yale Professor and 2014 Nobel Prize recipient) Cyclically Adjusted Price Earnings, or CAPE. This measurement, at the end of June, had the U.S. stock market priced at 27 times earnings for the past 10 years, more than 50% above the average of 16.

Believe it or not, however, not all experts agree the market is overvalued. There are prominent authorities, like Jeremy Siegel (Wharton professor and author of *Stocks for the Long Ru*n), and Jeremy Grantham (highly respected market strategist and notorious market bear) who feel they are fairly to slightly over-valued. Both state that the low interest rate environment has altered the traditional math on what constitutes fair valuations. In a Bloomberg article this past June, Professor Shiller himself agreed that record-low interest rates around the world have rendered some long-held financial theories useless, saying "I've been very wary about advising people to pull out of the market even though my CAPE ratio is at one of the highest levels ever in history……..Something funny is going on. History is always coming up with new puzzles." It is important to understand that market valuations are just predictions or forecasts of future returns. Like most predictions of the market, they are prone to be wrong, especially when even the experts don't agree! As a long-term investor, using such information to make short-term market direction decisions regarding a portfolio is a loser's game. All reputable economists, including Prof. Shiller, think that the CAPE, or any other valuation measures, **are not** useful tools to determine when to be in or out of the market – you should too.

The Fed will most likely (barring any detrimental economic news) raise short-term rates in September as indicated. US Economic statistics point to a stronger US Economy, one that would justify an increase. While many are anticipating a negative impact on financial markets, recent history of interest rate increases shows us something different:

Rate hike cycles	Total cycle increase	Annualized Returns Post First Rate Increase (%)									
		U.S. Equity		Non-U.S.		Bonds		REITs		Balanced	
		1-Yr	5-Yrs	1-Yr	5-Yrs	1-Yr	5-Yrs	1-Yr	5-Yrs	1-Yr	5-Yrs
7/80 6/81	10.00%	14.9	14.6	5.4	12.3	-5.0	13.5	16.8	21.0	6.3	14.8
5/83 - 8/84	3.25%	-7.1	13.8	14.1	6.8	0.4	8.7	11.3	14.7	1.5	11.1
12/86 - 9/87	1.38%	1.9	14.5	24.9	9.0	2.8	9.9	-3.7	6.5	7.3	11.7
3/88 - 2/89	3.25%	17.3	11.6	11.9	31.9	5.2	9.0	5.6	9.5	10.9	14.8
2/94 - 2/95	3.00%	6.0	22.1	-4.2	7.2	1.8	7.1	-3.7	7.3	1.6	12.5
6/99 - 5/00	1.75%	9.6	-1.1	17.4	0.4	4.6	7.0	3.0	14.5	9.0	4.0
6/04 - 6/06	4.25%	8.1	-1.9	14.1	2.8	6.8	5.0	32.7	-2.7	11.3	2.0

› Positive returns across most periods and asset classes

› Balanced portfolio positive in all periods

Source: U.S. Stocks: Russell 3000® Index, Non-U.S. Stocks: MSCI EAFE Index, Bonds: Barclays Aggregate Bond Index, REITs: FTSE NAREIT All Equity REIT Index; Balanced: 35% U.S. Stocks, 20% Non-U.S. Stocks, 35% Bonds, 10% REITs.

As the chart indicates, positive returns were experienced in most periods across most asset classes. Note that balanced portfolios (aka diversified portfolios) were positive across all periods. While this might not be the case in this go round, it does provide some perspective about the protection a balanced, well diversified portfolio can provide.

What all this means to you and your portfolio

It is always tempting to react to current events, especially when the media and other market pundits portray that the world has changed, or that "this time it's different" and you need to *do something*. Did you know, however, that you already have done something? By taking the initial steps to adopt a well-diversified investment strategy, you have prepared yourself as best you can to take on the repercussions of Greece, China, high market valuations, Fed interest rate hikes, and whatever other economic or market related events are coming down the pipe.

As we talked about in one of our previous communications, proper planning is the best approach to those things we can't control. As such, planning in general is not comprised of knee jerk reactions to uncontrollable events. Proper investment planning is predicated on prudent allocation of your investment portfolio and based on personal financial situation, risk tolerance, and risk capacity…not on what is happening in the world at any one given time. This is not to say we shouldn't look into and gain perspective on the events that affect the world around us, it just means that we need to stay disciplined to our strategy and let our broadly diversified portfolios help us weather the storm. When bad things happen, the best market timing strategy available is staying committed to your plan and rebalancing from bonds to stocks.

As always, thank-you for the opportunity to serve as your Financial Advisor – we look forward to talking with you soon.

Sincerely,

Doug Babcock, CFP®

Bob Frey, MS, CFP®