PROFESSIONAL
FINANCIAL
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Dear Client,

Enclosed, please find your 4th Quarter and 2015 Annual performance reports and our 2016 privacy policy. Please note that all tax information (if it applies to your account) will be sent in a separate mailing. We will also do our best to keep you abreast of tax reporting information with regard to your portfolio.

We are writing this quarter to provide you a summary of 2015 market performance, and with the global equity markets off to less than a "happy" start, we will also address the current/future volatility concerns amidst ongoing macroeconomic issues and negative outlooks on both the global economy and capital markets.

2015 – MARKETS IN REVIEW

The US economy and broad market showed modest gains during the year, although investor discipline was tested by news of a global economic slowdown, rising market volatility in China and emerging markets, falling oil and commodities prices, and higher US interest rates. While the S&P 500 Index logged a 1.38% total return, the best measure of overall US Market returns, the Russell 3000, gained .48% - its lowest return since the 2008 market downturn.

Performance among non-US markets was mostly negative: The MSCI EAFE Index logged a –.81% total return and the MSCI Emerging Markets Index a –14.92% return (net dividends, in USD). The US dollar's strong performance against major currencies resulted in lower returns for US investors in various markets. For example, the MSCI All Country World Index returned 1.27% in local currency but –2.36% in USD (net dividends).

For US stocks this past year, both the Relative Price (Value) and Size (Small Cap) premiums failed to materialize with Value oriented stocks underperforming Growth oriented stocks and Small Cap stocks underperforming Large cap stocks. International Developed and Emerging Market asset classes experienced a positive size premium with Small cap stocks outperforming Large Cap stocks. However, Value premiums were negative in both of these asset classes. Of note here and as we explained in our letter last quarter, annual underperformance of the size and value premiums is not unusual from a historical standpoint. Although small cap and value stocks have offered higher than expected long-term returns relative to their large cap and growth counterparts, these return premiums do not appear each year. This should not be concerning and we will be putting out more information that focuses on this topic in the weeks to come, as well as discussing this in your upcoming portfolio review.

LIVING WITH MARKET VOLATILITY CONCERNS

While the year ended with somewhat flat returns, market volatility returned in 2015 and has reappeared in the last couple of weeks, causing an understandable level of anxiety for clients. With continued concerns about oil prices, China, interest rates, and the global economy, we need to understand that we could be facing extended volatility for a time to come, as these issues undoubtedly will take some time to work themselves out. So this begs the question, is this normal? The short answer, while not a pleasant one, is yes. On average, the market has shown to retreat 14% from its highs each year, sometimes more and sometimes less. Understandably, however, it seems extraordinary given the low level of volatility experienced over the past few years and then suddenly, observe two highly volatile periods in just a four month window.

As we mentioned in commentary a few weeks back, there are certainly many signs that still show the US economy is on strong footing. However, the arguments of a potential global slowdown combined with negative market sentiment could undermine consumer confidence, creating the self-fulfilling prophesy of a US economic slowdown

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or recession. We do not know this to be the case right now and we admittedly are not in the business of predicting or forecasting markets. However, we do need to address the possibility of extended poor market performance.

While the causes of prior recessions are many, the response of capital markets are consistent. Market prices of securities adjust to appropriate levels, regain footing and move higher as the economic cycle turns positive. The premium over inflation gained in the capital markets is earned not by just participating in bull markets, but also by enduring emotional discomfort when prices decline or correct. No one can predict what will happen next – this is the nature of risk. While we know we "preach to the choir" when discussing the need to stay calm and let your designed strategy work for you, we understand it is not always easy to ignore the headlines and stay focused on the long-term. Should the latter be the case, here are seven simple truths to help you live with volatility (courtesy Jim Parker, Vice President, Dimensional Fund Advisors):

1. **Don't make presumptions -** Remember that markets are unpredictable and do not always react the way the experts predict they will. For example, when central banks relaxed monetary policy during the crisis of 2008-09, many analysts warned of an inflation breakout. However, if anything, the reverse was the case as central banks fretted more about deflationary concerns.
2. **Someone is buying -** Quitting the equity market when prices are falling is like running away from a sale. While prices have been discounted to reflect higher risk, that's another way of saying expected returns are higher. And while the media headlines proclaim that "investors are dumping stocks," remember someone is buying them. Those people are often the long-term investors.
3. **Market timing is hard -** Recoveries can come just as quickly and just as violently as the prior correction. For instance, in March 2009—when market sentiment was at its worst—the S&P 500 turned and put in seven consecutive months of gains totaling almost 80%. This is not to predict that a similarly vertically shaped recovery is in the cards, but it is a reminder of the dangers for long-term investors of turning paper losses into real ones and paying for the risk without waiting around for the recovery.
4. **Never forget the power of diversification -** While equity markets have turned rocky again, highly rated government and short-term corporate bonds have flourished. This helps limit the damage to balanced fund investors. So diversification spreads risk and can lessen the bumps in the road.
5. **Markets and economies are different things -** The world economy is forever changing, and new forces are replacing old ones. This applies both between and within economies. For instance, falling oil prices can be bad for the energy sector but good for consumers. New economic forces are emerging as global measures of poverty, education, and health improve. A recent OECD study shows how far the world has come in the past 200 years.
6. **Nothing lasts forever -** Just as smart investors temper their enthusiasm in booms, they keep a reserve of optimism during busts. And just as loading up on risk when prices are high can leave you exposed to a correction, dumping risk altogether when prices are low means you can miss the turn when it comes. As always in life, moderation is a good policy.
7. **Discipline is rewarded -** The market volatility is worrisome, no doubt. The feelings being generated are completely understandable and familiar to those who have seen this before. But through discipline, diversification, and understanding how markets work, the ride can be made bearable. At some point, value re-emerges, risk appetites reawaken, and for those who acknowledged their emotions without acting on them, relief replaces anxiety.

As we meet and talk with you this year we will be taking the opportunity to discuss your long-term plans and to be sure your portfolio is focused on your long-term objectives as well as positioned to weather short-term storms. 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®