PROFESSIONAL FINANCIAL MANAGEMENT, INC.
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Dear Client,

Enclosed, please find your 4th Quarter and 2016 Annual performance reports, and our 2017 privacy policy (invoice sent separately). Tax information will be forthcoming and we will do our best to keep you informed on its availability.

We hope your 2017 is off to a good start! 2016 was a year of many un-expected outcomes, with financial market returns providing one of these surprises. With everything going on in the world right now, it is more important than ever to keep a level perspective and we will discuss this further following our overview of what transpired in the markets this past year.

2016 – MARKETS IN REVIEW

In stocks, the US market reached new highs and equity markets in many developed and emerging market countries experienced positive returns. The year began in a dour fashion as anxiety over the Chinese economy coupled with falling oil prices and the potential of a US recession, resulted in steep US market declines that set a record for the worst start to any calendar year in history. However, markets began to improve mid-February and finished the first three months with the largest quarterly comeback since the Great Depression. They continued to move up through mid-year, suffered a sharp set-back in the aftermath of the BREXIT vote, and then quickly recovered to new highs in July. Focus on the US election created anxiety and a market sell-off prior to election day. On election night, as returns came in, the futures market stared down large losses. However, in dramatic fashion, markets took a 180-degree turn, closing 200 points higher the day after the election and against all speculation, finished the year near all-time highs.

Though not quite as dramatic as stocks, bonds did experience a little excitement of their own. Yields did fall due to the initial concerns with the equity markets, and then saw a sell-off following the election (the likes that had not been seen in over two decades) that drove yields to near present levels by year-end. The Bloomberg Barclays US Aggregate Bond Index gained 2.65%. Rates in general increased (yields on shorter term debt increased but yields on longer term debt remained relatively unchanged) in the US but decreased globally.

Looking at the broad market indicies (below), the US outperformed both International developed and emerging markets for the year. US real estate investment trusts (REITS) recorded positive returns but lagged both the US and International equity markets:

	US Stock Mkt.	International Dev. Mkts	Emerging Mkts	US Real Est.	US Bond Mkt.	Global Bond–ex US
Q4 ‘16	4.21%	-.36%	-4.16%	-2.53%	-2.98%	-2.21%
2016	12.74%	2.75%	11.19%	6.68%	2.65%	5.13%

Source: Russell, MSCI, Wilshire, Barclays and Citigroup

The factor premiums (Relative Price -Value, and Size- Small Cap) played a large role in 2016 portfolio returns. The value premium (excess return of value stock over growth stocks) was positive in the US, International developed and international emerging markets across all size ranges. The small cap premium (excess return of small company stocks over large company stocks) was positive in both the US and international developed markets, but not in emerging markets. Though 2016 was a generally positive year for these premiums, investors may still be wary following several years of underperformance for both value and small cap stocks. However, taking a longer-term perspective, the premiums remain persistent over decades and around the globe despite recent years’ headwinds. The small cap and value premiums are well-grounded in financial economics and verified using market data spanning decades, but pursuing these premiums requires a consistent, long-term approach, as we have no idea when they will occur or to what extent the benefit will be.

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STAYING FOCUSED AND TRUSTING YOUR STRATEGY AMID UNCERTAINTY
As noted at the outset of this letter, 2016 was certainly a year full surprises, with arguably the most prominent being the outcome of the November Presidential election. Surprises can be good or bad, depending on one's perspective. One thing we do know, however, is that surprises can create uncertainty, something that unnerves investment markets.

Changes in administrations typically create uncertainty – no one really knows what to expect. While these are normal reactions, the Trump administration has managed to create a much higher degree of concern and emotion than previous incoming administrations. While heightened emotions may be warranted, they do tend to wear on the nerves of investors. Even though we may not react to our emotions, they may lead us to doubt the plans and processes we have in place. So, no matter which direction markets go, look beyond the short-term noise and consider the following.

What has changed regarding your long-term goals? For many younger investors, the main long-term goal is securing a safe retirement. For those near or in retirement, the goal is not to run the risk of running out of money before time. Either way, these goals are not 1, 3, or even 5 year goals – they are likely 10, 15, 20, or 25 year goals. If none of this has changed, then there should be no reason why your investments should change.

Granted, your allocation mix (stocks vs. bonds) may need to be updated depending on where you are in life, but this is more a change related to your personal situation, not a reaction to short-term worries and concerns. Changes to portfolios should be predicated on what is going on in your life, not what is happening in the world at any given time. A long-term investor understands that you can only control what you can control. Your investment plan/strategy is designed around universally accepted principles, in conjunction with your long-term needs, to provide you highest probability of success. The events in the short-term are just noise. Keep reminding yourself that you do have a process that is designed to provide benefits in both prosperous and unprosperous times.

Politics and Government do not drive investment markets*.* Contrary to what we might like to believe, the political party in government, particularly that of the current president, has historically had very little influence on US stock market performance. Long-term stock market performance is predicated on the fundamentals (i.e. earnings growth and valuations) of the companies that make-up the marketplace, with little to no impact from the policies of the administration in Washington. A good example of this was President George W. Bush's move to increase military spending. The market speculation was that defense and aerospace stocks would excel over the broad market. The result: Aerospace stocks only marginally beat the S&P 500 over the term of his presidency. Another example was when President Obama championed his national healthcare initiative (the Affordable Care Act). The speculation was an overall negative impact on healthcare stocks. The result – Healthcare stocks performed marginally better that the S&P 500 through his presidency.

While policies and regulations may influence how companies do business, capitalism thrives because they strive for profitability and will adapt and move forward. Also, understand that much of current stock market performance has more to do with where we are in the current business cycle, and less to do with who is in the White House and what is coming out of Washington. There is so much more to market performance than a president's actions, and more importantly, what is said on Twitter!

Process, strategy and patience will always beat speculation*.* If we learned anything in 2016, it was to not trust the headlines or the opinions of the market guru's and political pundits. Many investors may not have expected a globally diversified portfolio of stocks and bonds to deliver positive returns in the face of such a tumultuous year…but it happened. This exemplifies the importance maintaining a diversified approach to all pertinent asset classes in all regions of the world, with emphasis on those areas of the markets that tend to do better than others. While not all asset classes had positive returns, this approach delivered attractive returns in 2016.

As long-term investors, we need to understand that global markets are extremely efficient at processing information and incorporating all available news and expectations into prices. Rather than trying to speculate and guess, investors are best served by staying the course with a proven strategy and plan that works most of the time and will keep them in line to achieve their long-term goals no matter what the economic landscape. Being patient and trusting in your strategy will arguably be much less frustrating than sitting and worrying about what to do next in response to news and events.

Undoubtedly, many more uncertainties lie ahead, but as long-term investors, we can't let short term outcomes sway long-term plans if we have any hope of achieving our goals. Eugena Fama, DFA Director and 2013 Nobel Prize winner in Economics sums this up by saying, quote *"If three or five years of returns are going to change your mind (on an investment), you shouldn't have been there to begin with."*

Thank-you for the opportunity to serve as your financial advisor and we look forward to assisting you in the accomplishment of your current and long-term goals.

Sincerely,

Doug Babcock, CFP®