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Dear Valued Client-

"Happy Springtime" – yes, it is spring, and as I write this letter, the ground is white and it continues to snow! We do hope you are getting outside to enjoy the "change" of seasons where you are.

What a difference a year can make. This time last year the market was recovering from a correction like start, while this year we are in almost the opposite position with a US stock market at lofty valuations seemingly waiting for a correction to occur. It is no coincidence that we again discuss the subject of diversification, however, this time with an emphasis on the importance of maintaining a global allocation amidst an expensive US market and the long-term risk/return benefits afforded by such exposure. Before we begin this discussion, here is a brief review of how markets fared this past quarter.

1st quarter 2017 in Review

The US economy continued to expand while global markets continued to gain momentum, despite the political acrimony that dominated headlines this past quarter. From a broad market perspective, all major world asset classes finished the quarter with reasonable advances. In terms of US dollars, emerging markets lead the way followed by International developed markets and then US stocks. US Bonds were reasonably resilient in spite of a second successive rate hike from the Fed, although international returns slipped slightly into negative territory.

	US Markets	International Dev. Mkts	Emerging Mkts	US Real Est.	US Bond Mkt.	Global Bond–ex US
Q1 '17	+5.74%	+6.81%	+11.44%	-.27%	+.82%	-.35%

Source: Russell, MSCI, Dow Jones, Barclays and Citigroup

On the size and relative price spectrums, results were mixed. Value oriented stocks underperformed growth stocks in the US, international developed and emerging markets for the quarter. Small company stocks outperformed large company stocks in both the international developed and emerging market arenas, but underperformed in the US. For a full breakdown on market performance, please refer to the Q1 Quarterly Market Review on our web-site, if interested.

Benefits of global diversification

Every now and again, the question arises about the benefits of maintaining exposure to International and Emerging Market stocks while US stocks outperform. In recent years, US markets have done well relative to many non-US markets, so it is easy to see how this mentality may make its way into the minds of investors. From 2010 through 2016, the S&P 500 index returned 12.83%, while the MSCI EAFE Index (developed countries) returned 3.81%, and MSCI World ex USA Index (developed and emerging markets) returned just 3.64%. While this may cause investors to question the merits of diversifying across countries and thus reallocating to markets that have recently done well, using return differences over such a short time period as the sole input for this decision could result in missed opportunity.

To explain, let's look at the time-period from 2000 – 2009, deemed "The Lost Decade" due to the S&P 500's worst 10-year annualized performance of -.95%. International developed and emerging market stocks produced positive annualized returns over this same period, with the MSCI World ex-USA Index returning 1.62% and the MSCI Emerging Markets Index returning 9.78% (as a side note, tilting the portfolio toward

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value and small cap stocks across all asset classes over this same period not only enhanced diversification but further improved returns – a topic for another day). Again, however, short-term periods don't tell the story. So, expanding the time-period to provide more meaningful data, research shows that in the 11 decades from 1900 – 2010, the world market out-performed the US market in six of those 11 periods, or 55% of the time. This gives credence to the notion that a global allocation could play a significant role in helping maximize the equity premium by positioning portfolios to capture returns wherever and whenever they occur (Source: Annual country index return data, Dimson-Marsh-Staunton Global Return date – Morningstar).

Enhanced investment opportunity through broad exposure. Through the end of 2016, US stocks accounted for only 54% of the world's market capitalization. Investors focusing solely on a Large Cap US Equity portfolio forgo exposure to a sizable 46% of world market capitalization (approx. 8,000 companies in over 40 countries) and the returns these markets generate (Source: Bloomberg, provided by Dimensional Fund Advisors – see Exhibit 1). The diversification and return benefits gained from the inclusion of international and emerging market companies can't be overstated. However, just like picking individual stocks, trying to pick individual countries based on past performance or concentrating holdings in only one or a few of these countries could prove detrimental. Broad exposure across all world markets is the key to effective diversification, helping provide a more desirable outcome than investing in any one single country. A popular chart (known as the quilt chart – see Exhibit 2) provides a great visual example of this, ranking the investment performance (from highest to lowest) of 19 different developed market countries over the past 20 years. In summation, not only is it virtually impossible to know what country will be the best performer in any given time-period, but the spread in the returns between the best performing and worst performing countries can be quite large, meaning concentration of exposure in any one country could add substantial portfolio risk.

How investors benefit. So, what are the long-term benefits gained by maintaining a globally diversified portfolio? When compared to an investor who invested solely in the S&P 500 for an extended time frame (1970 through the end of 2016), quite remarkable. In short, the global portfolio bested the S&P 500 in 29 of the 47 years included in this period, or 62% of the time (Source: Dimensional Fund Advisors – see Exhibit 3). More importantly, the global portfolio was neither the best or worst performer in any year throughout the period, suggesting that diversifying can reduce the extreme outcomes common to a concentrated approach. Of final note, the global portfolio outperformed the S&P 500 by over this period by an annualized 3.3%, doing so with only a slight increase in overall risk (as measured by standard deviation).

What this means for your portfolio. Our goal is to continually educate you regarding construction of your portfolio and how your strategy works – transparency is key! While much goes into determining exposure to the world's asset classes when building a portfolio (see Q3'15 letter on portfolio construction), the important points to remember here are that:

- Over long time periods, investors benefit from consistent exposure to both US and non-US stocks;
- While US, international developed and emerging market stocks have the potential to earn positive long-term expected returns, they are not directly correlated, meaning they may perform differently over shorter time periods;
- The individual performance of any one country or asset class will vary with time, making it impossible to guess who the winners will be in any given year – broad exposure is necessary and helps to capture available returns as they occur; and
- A globally allocated portfolio provides both diversification and potentially higher expected returns.

With a great deal of attention in the media surrounding US market valuations, discussion about global diversification is a timely topic. While we have no way of knowing what will happen near term (or ever!), we do know that having a globally diversified approach can help capture some of the upward momentum

experienced on the international front as of late, while potentially absorbing some of the fall-out of a US market correction should one occur.

As we have always stressed, investing is a game of probabilities and focusing on principles, fundamentals and practices that work "most the time" are keys to a successful long-term investment experience – global diversification is one of these principles. A statement from a recent Russell Investments publication sums up the importance of diversification, especially in today's markets, stating: Appreciate US Stocks when they are winning….and be grateful for diversifiers when they are not.

Thank-you for the opportunity to serve as your financial advisor.

Sincerely,

Doug Babcock, CFP®