PROFESSIONAL FINANCIAL MANAGEMENT, INC.

QUARTERLY NEWSLETTER

2019 Second Quarter

Dear Client,

We hope you are well and enjoying your summer (even if it feels like it just arrived!). Second quarter statements are out so you should have your information shortly. As always, please take the time to compare the information on your report to your account statements received from TD Ameritrade or other custodians, and promptly contact the office should you find material discrepancies (note that there might be slight discrepancies due to the timing of the credit of dividends or transactions at quarter end). Also, if you are not receiving account statements directly (either in print or electronically) from TD Ameritrade or other custodians, notify us immediately.

The financial markets continued their upward march with all major asset classes of both stocks and bonds posting gains through the end of the quarter, essentially erasing the losses (paper losses!) experienced in 2018. While markets have struggled quarter-to-date, they continue to hang on to respectable gains for the year. Ongoing tariff and trade war concerns, with temporary truces, seemed to dominate headlines and have the largest influence on global markets this past quarter (and still do as of the writing of this letter!). The emotional highs and lows of these headlines continually test our investment resolve, bolstering the notion that psychology is equally as important as strategy when it comes to investing! We will discuss this a bit further in our commentary following our brief quarterly market summary.

2Q'19 Market Review

To reiterate earlier comments, markets finished the first half of 2019 with impressive results. On the equity front, stock asset classes around the world finished in positive territory for the quarter, the only exception being emerging market small cap stocks which finished slightly down. US stocks outpaced both international developed and emerging markets for both the quarter and the first six months of 2019. On the bond front, interest rates decreased on the quarter, boosting returns. Short-term corporate bonds increased 2.09% but were bested by intermediate bonds, which returned 3.13%.

On the strategy front, Value stocks outperformed growth stock in emerging markets, but underperformed in both the US and international developed markets. Small cap stocks underperformed large cap stocks in all major asset classes. REITS had positive returns but underperformed both US and international developed market stocks (all *information courtesy of Dimensional Fund Advisors).* Both value and small cap struggles continue to impact portfolio returns against the broad market benchmark. As unpleasant as this might be, however, short-term tracking error is expected behavior and should not be a distraction to long-term goals and what we expect to be long-term market outperformance.

If you wish to view a more detailed re-cap of the markets, please go to our website and see the full market review under the "News" tab. Below is a summary of broad market index performance for the quarter based on the asset class exposure in your portfolio:

	US Stock Mkt.	**International Dev. Mkts**	**Emerging Mkts**	**US Real Est.**	**US Bond Mkt.**	**Global Bond–ex US**
Q2'19	4.10%	3.79%	0.61%	1.63%	3.08%	2.75%
2019 YTD	18.71%	14.64%	10.58%	17.92%	6.11%	5.79%

Source: Russell, MSCI, Wilshire, Barclays and Citigroup

Market "noise" and investor distraction – a refresher

We've discussed the effect of distracting headlines and news stories as it relates to investing in prior communication and while you probably agree it makes sense to ignore "noisy" distractions in pursuit of your financial goals, do you know how to differentiate between what is noise and what is substance?

Let's take a refreshing journey back to May 2018, when the CFA Institute hosted its 71st Annual Conference in (of all places) Hong Kong. It's also where Nobel Laureate and behavioral economist Daniel Kahneman presented how to improve on decisions by tuning out the "noise."

Kahneman and his research partners offer us important insights on this front. In an October 2016 *Harvard Business Review* article, they define noise as how widely different people's interpretations of the exact same information tends to vary. When judgments based on the same data vary by a lot, they're considered noisy … because how do you know who's right?

For example, as reported in the HBR article, Kahneman and colleagues measured the noise levels at two financial service organizations by presenting identical case studies to multiple participants at each firm. The firms' executives predicted judgments might vary 5%–10% of the time. Instead, on average, different professionals' judgments varied ***between 48%–60% of the time***.

This outcome is not exclusive to financial types. Kahneman found similar results across doctors, judges, loan officers, and other professionals. Bottom-line, even educated judgments can be very "noisy," and that's before we even consider the din of discussion we're subjected to daily from a never-ending global feed of often insignificant information.

Relating this to your portfolio

Let’s bring this back to investing. Does this mean ***everything*** you hear is noise, and ***nobody*** knows what’s going on? In terms of breaking news, it probably does. That’s why it’s all the more important to heed the tips Kahneman shared with CFA conference attendees:

1. **Be disciplined**. Kahneman refers to using algorithms, or evidence-based rules, for quieter, more consistent outcomes. Following such rules may not deliver as hoped for every time, but it should outperform excessive judgments (even from the “experts”).

2. **Think big picture**. Kahneman suggests: “See the decision as a member of a class of decisions that you’ll probably have to take.” This includes avoiding regret over past outcomes as “probably the greatest enemy of good decision making in personal finance.”

3. **Be open to noise-dampening advice**. Seek advice that helps you tune out rather than amplify judgmental noise. As Kahneman describes, a good advisor is a “person who likes you and doesn’t care about your feelings.”

Okay, maybe we ***do*** care about your feelings a little bit. For example, if you’re feeling the heat from this summer’s unfolding news, we hope you’ll be in touch with your questions or concerns. We’ll help you separate the sound from the substance.

We appreciate your confidence and look forward to discussing your situation in the coming weeks and months.

Sincerely,

Your PFM Advisory Team

PS: As discussed in recent communication, the value premium has been in hiding for quite a while. As value stocks play an important role in your investment strategy, the question becomes should you continue to pursue their expected premium? We have some additional information we would like to share on why our perspective remains the same as ever - we’d be delighted to share this with you upon request. We also plan to go over this with you in person at your upcoming review – we will be in touch.

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