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Planning Perspectives

1Q 2017

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2016
Annual Market Review

2016 Annual Market Review

This report features world capital market performance and a timeline of events for the last year. It begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the impact of globally diversified portfolios.

Overview:

Disclosure: Professional Financial Strategies, Inc. is an investment advisor registered with the Securities and Exchange Commission, and an independent, fee-only firm.

Please remember that past performance may not be indicative of future results. Indexes use for illustration purposes are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Professional Financial Strategies, Inc.), or any non-investment related content made reference to directly or indirectly in this whitepaper, will be profitable, or equal any corresponding indicated historical performance level(s), or be suitable for your portfolio or individual situation, or prove successful. All expressions of opinion are subject to change without notice in reaction to changing market conditions and/or applicable laws. Due to various factors, such as rapidly changing market, social or geopolitical conditions, content herein may no longer be reflective of current opinions or positions of Paul Byron Hill or Professional Financial Strategies, Inc.

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New Market Highs and Positive Expected Returns

January 2017

There has been much publicity recently in the media about record nominal highs in popular stock indices like the Dow Jones Industrial Average crossing the 20,000 point threshold, or the S&P 500 index continuing its long rise. Many investors did not expect most global equity markets to deliver positive returns during a tumultuous 2016.

When stock markets hit ever new highs, is that news a usable timing indicator for smart investors to cash out? Perversely, Wall Street professionals and institutional investors—worried about career risk—seemed more concerned about missing out on the action. Historical evidence shows us that just because a market index is at an all-time high, that information alone does not provide useful actionable information for investors. Let's look at the S&P 500 Index for the better part of the last 100 years.

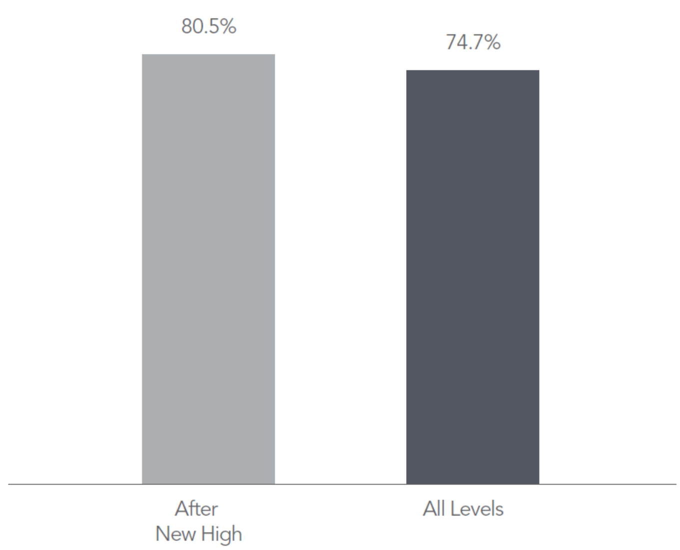
Exhibit 1 shows that from 1926 through the end of 2016 the proportion of annual returns that have been positive after a new monthly high is similar to the proportion of annual returns that have been positive after any index level. In fact, over this time period *almost a third of the monthly observations were new closing highs for the index*. This data makes clear that simply attaining a new index high historically has not been a useful predictor of future returns.

Given that the nominal level of an index by itself does not seemingly predict future realized returns, you may ask yourself a more fundamental question: What drives expected returns for the growth of wealth from stocks?

Expected Returns Are Positive Returns

One way to compute the current value of an investment is to estimate the future cash flows that investment is expected to deliver and then discount the present value of those flows back into today's dollars. For an investment in a firm's stock, this type of valuation method links expectations that market participants have about a firm's likely future profits to its current stock price through a financial discount rate. The consensus

Exhibit 1: S&P 500 Total Return Index Highs: 1926–2016
Percent of Months with Positive Return Over Next 12-Month Period



From January 1926–December 2016, 319 months, or approximately 29% of monthly observations, were new closing highs.

Note: 1,081 monthly observations.
The S&P data is provided by Standard & Poor's Index Services Group. For illustrative purposes only. Index is not available for direct investment. Past performance is no guarantee of future results.

New Market Highs and Positive Expected Returns

(continued)

discount rate implied is the "cost of capital" for that firm, industry or sector based on prevailing global economic conditions of the time.

The discount rate incorporated into the price paid for a stock (or for a group of stocks, such as those comprising an index) equals an investor's expected return. A simple, but important, insight we glean from this is that the expected return from holding a stock in a fair trade is driven (1) by the price paid for it and (2) by what its investors expect to receive. Stock prices are the result of the interaction of many willing buyers and sellers. It is extremely unlikely that in aggregate, buyers would willingly apply negative discount rates to expected profits of firms they purchase. Why?

Due to risk—recognizing the uncertainty that expected profits of the firm may not materialize or that the stock price might decline because of unanticipated future events, thereby increasing the cost of capital and causing the price of the stock to decline. If investors apply positive discount rates to the cash flows they expect to receive from owning a stock, we should expect the price of that stock to represent a level such that its expected return is always positive. Unless expected cash flows are persistently biased downward or upward, we can expect this to be the case.

There is little evidence, though, that the aggregate expectations of investors as buyers and sellers that set market prices have been persistently biased downward or upward. Many studies document that professional money managers have been unable to deliver consistent outperformance by outguessing the direction of market prices. In the end, prices set by market forces that are exceedingly difficult to outguess. The market does a good job setting prices, so we should assume that the expected return investors are applying when setting prices is not biased.

Therefore, it is reasonable to assume that the price of a stock, or better, the price of a basket of stocks like the S&P 500 Index, should be set to a level such that its expected return is positive, regardless of whether or not that price level is at a new high. Even when *realized returns* are negative for a period of months or even years, *expected returns* are still positive. This helps explain why new index highs in **Exhibit 1** have not, on average, been followed by negative returns. *At a new high, a new low, or something in between, expected returns for the investor are always positive.*

Expected Returns, Realized Returns, And Holding Horizons

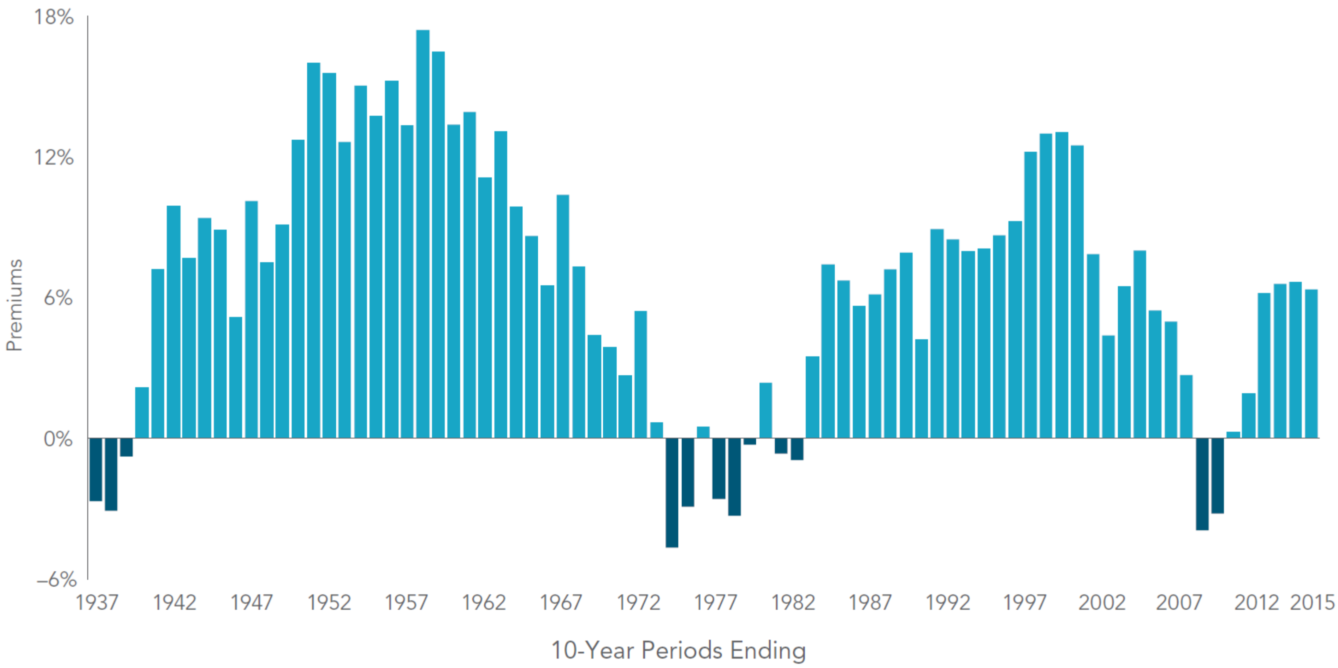
Today's prices depend on expected returns and expectations about future profits among investors collectively. Global markets are vast information-processing machines that incorporate news and expectations into prices. If either expected returns or expectations about future profits change for market participants, prices of stocks and other securities will also change almost immediately to reflect this new information. Changes in risk aversion, tastes and preferences, expectations about future profits, or the quantity of risk can all drive changes in expected returns.

All else being equal, an increase in expected returns is reflected through a drop in prices. A decrease in expected returns is reflected through a rise in prices. *Thus, realized returns will differ from expected returns.* The realized return on any stock, an index like the S&P 500, or the market as a whole can be negative as prices decline, frequently even dramatically, although expected returns will remain positive as declining prices adjust for risk.

Because we know that realized returns can be negative, or at least disappointing relative to the investor's expectations for planning, what is the probability of a positive realized return during an investor's holding horizon? **Exhibit 2** shows rolling 10-year performance of the U.S. equity market premium (equity returns minus the return of one-month US Treasury bills, considered to be a risk-free investment). In most 10-year rolling periods

New Market Highs and Positive Expected Returns
(continued)

Exhibit 2: Historical Observations of 10-Year Premiums
Market minus one-month Treasury bills: US markets



Information provided by Dimensional Fund Advisors LP. In US dollars. The 10-year rolling equity premium is computed as the 10-year annualized compound return on the Fama/French Total US Market Index minus the 10-year annualized compound return of the one-month US Treasury Bill. Fama/French indices provided by Ken French. Index descriptions available upon request. Eugene Fama and Ken French are members of the Board of Directors for and provide consulting services to Dimensional Fund Advisors LP. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

it was positive, but in several periods that premium was negative. Also the amount of the equity premium has varied widely over time. The length of underperforming periods is unpredictable. Historically, however, the probability of realizing positive equity return premiums, and the likelihood of realizing high equity premiums, increases as the holding period used for evaluating the investment outcome of an equity index like the S&P 500 Index, increases.

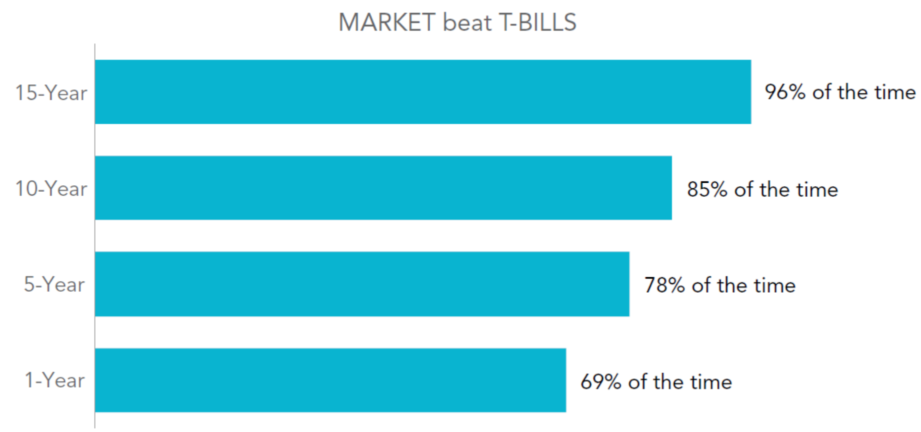
Exhibit 3 shows the percentage of time that the U.S. equity market premium was positive over different time periods of the past 100 years. When the length of the time period measured increases, so does the chance of the equity market premium being positive. So to answer our question from before: as an investor's holding period increases, the probability of a having negative realized return decreases. This is why it is important for an investor to choose a level of equity exposure that they can sustain for the duration of their financial planning horizon. An essential key to success for any investor strategy is not futilely timing markets, but their time in the right markets.

Conclusion

Knowing that the Dow or any market index or sector has attained at a new record high not a useful predictor of future returns based on the historical evidence. That information alone does not tell us whether to hold on or to cash out. While positive realized returns are never guaranteed, a sound understanding of economic fundamentals teaches that equities and other securities will have positive expected returns regardless of index levels or regardless of short- or long-term past performance.

New Market Highs and Positive Expected Returns
(continued)

Exhibit 3: Historical Performance of Equity Market Premium over Rolling Periods
US markets overlapping periods: January 1928–December 2015



Market is Fama/French Total US Market Index. T-Bills is One-Month US Treasury Bills. There are 877 overlapping 15-year periods, 937 overlapping 10-year periods, 997 overlapping five-year periods, and 1,045 overlapping one-year periods.

Information provided by Dimensional Fund Advisors LP. Based on rolling annualized returns using monthly data. Rolling multiyear periods overlap and are not independent. This statistical dependence must be considered when assessing the reliability of long-horizon return differences. Fama/French indices provided by Ken French. Index descriptions available upon request. Eugene Fama and Ken French are members of the Board of Directors for and provide consulting services to Dimensional Fund Advisors LP. Indices are not available for direct investment. Past performance is no guarantee of future results.

The collective wisdom of market participants and their competitive assessment of expected returns and aggregate risks allow informed investors to devise multifactor strategies based on information contained in security prices to structure successful equity and fixed income asset allocations for their portfolios based on what we have learned from financial science.

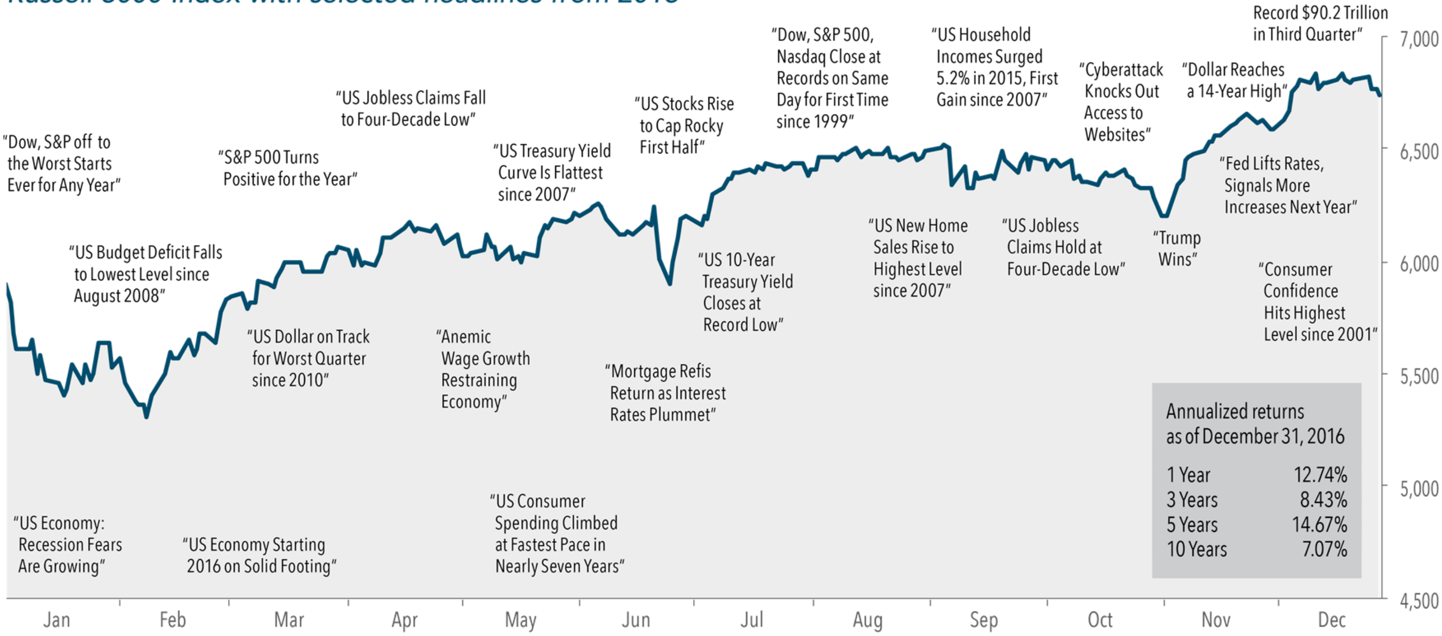
The persistence of any asset class or index returns varies greatly year-by-year. From the evidence we have, the odds of positive realized stock returns increases over long holding horizons. This is why investing, as opposed to speculation, must be an educated, long-term commitment: Staying invested and not making changes based on short-term predictions or troubling events increases your likelihood of investing success.

The dramatic market turnaround during 2016 highlights the critical importance of globally diversifying across asset classes, sectors and markets, as well as staying disciplined despite all the tribulations and turmoil publicized last year. Informed investors generally are best served by staying the course and working with a competent CFP professional to develop a sensible asset allocation strategy with a systematic focus on factor premiums that reflects their needs, goals, dreams, risk preferences, and time horizons to better weather investing uncertainty in all of its risky forms.

> *"There's no information in past returns of three to five years. That's just noise. It really takes very long periods of time, and it takes a lot of stick-to-it-tiveness. You have to really decide what your strategy is based on long periods of returns, and then stick to it. . . . If three or five years of returns are going to change your mind [about holding an investment position], you shouldn't have been there to begin with."*
>
> Dimensional video interview with Professor Eugene Fama, University of Chicago, Nobel Laureate in Economics

US Stock Market Performance

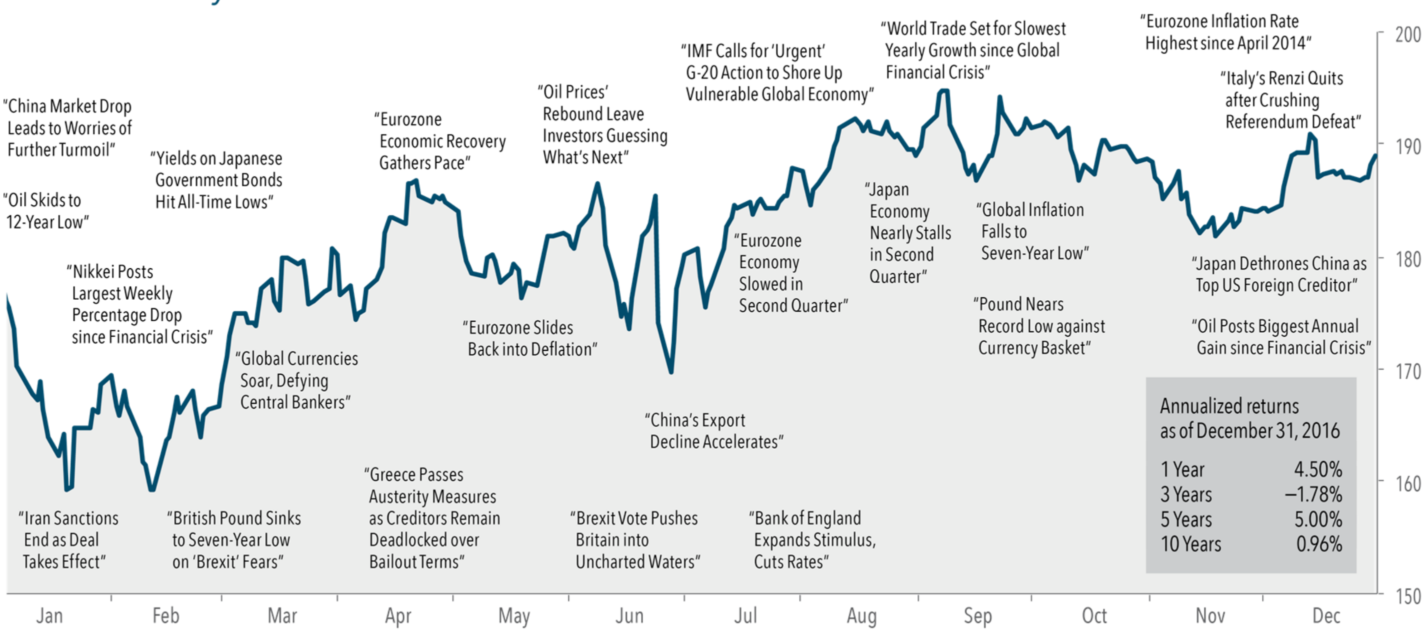
Russell 3000 Index with selected headlines from 2016



Source: Frank Russell Company.
Past performance is no guarantee of future results. In US dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

Non-US Stock Market Performance

MSCI All Country World ex USA Index with selected headlines from 2016



In US dollars. Source: MSCI ACWI Index (net dividends). Past performance is no guarantee of future results.. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on news.

Market Summary

Index Returns

2016	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	12.74%	**2.75%**	**11.19%**	**5.77%**	**2.65%**	**5.13%**
Since Jan. 2001						
Avg. Annual Return	7.6%	5.9%	13.3%	11.2%	4.9%	4.6%
Best Year	33.6% **2013**	39.4% **2003**	78.5% **2009**	37.4% **2006**	10.3% **2002**	9.8% **2014**
Worst Year	-37.3% **2008**	-43.6% **2008**	-53.3% **2008**	-45.7% **2008**	-2.0% **2013**	1.4% **2013**

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citi WGBI ex USA 1−30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2017, all rights reserved. Bloomberg Barclays data provided by Bloomberg. Citi fixed income indices copyright 2017 by Citigroup.

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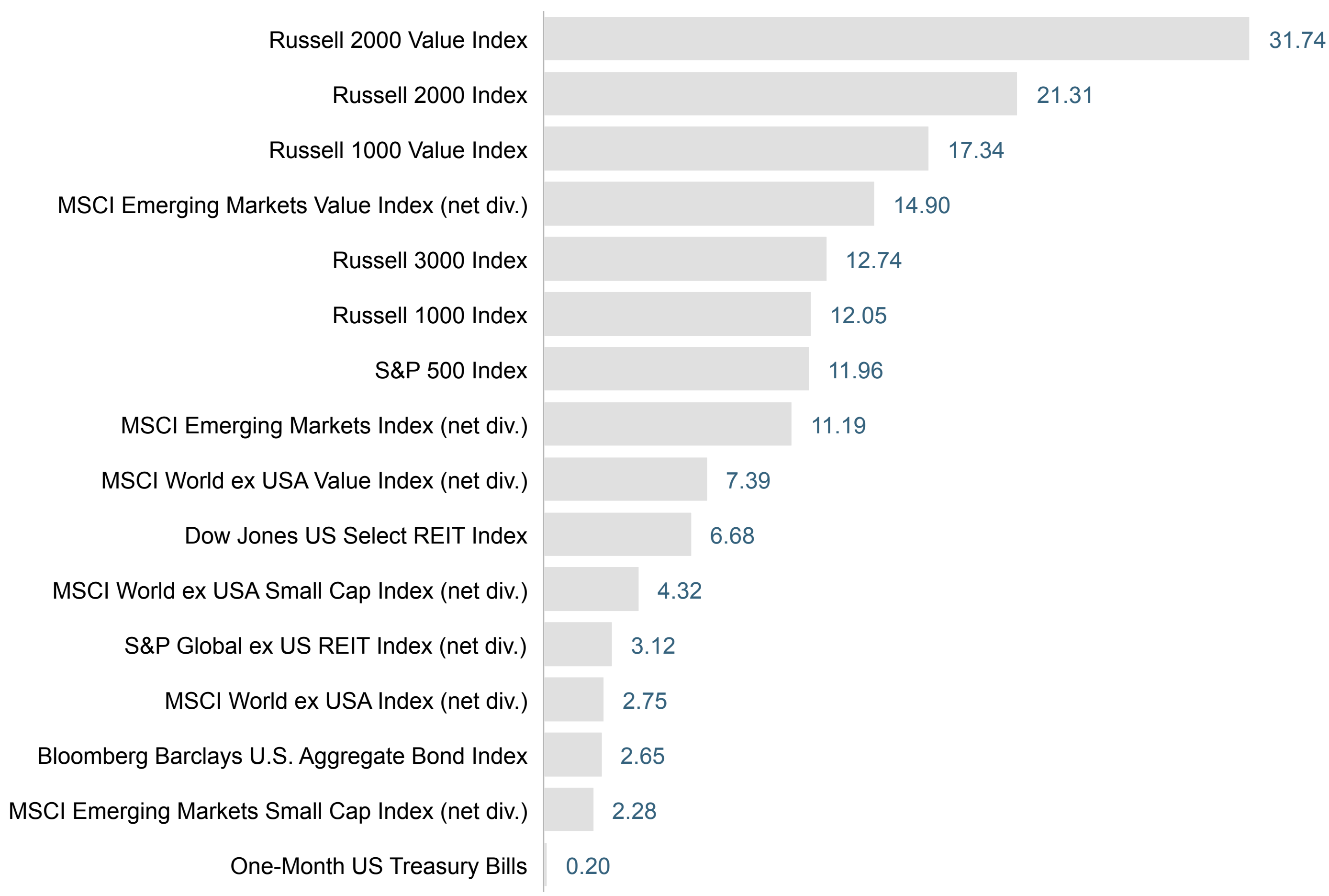
World Asset Classes

2016 Index Returns (%)

Looking at broad market indices, the US outperformed both non-US developed and emerging markets for the year. US and non-US real estate investment trusts (REITs) recorded positive returns but lagged the US and non-US equity markets.

The value effect was positive in the US, non-US, and emerging markets across all size ranges. Small caps outperformed large caps in the US and developed markets outside the US but underperformed in emerging markets.



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US Stocks

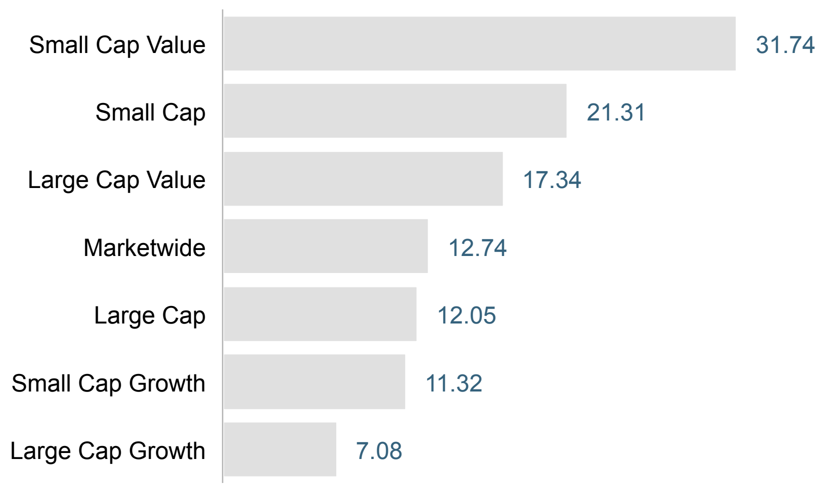
2016 Index Returns

The broad US equity market recorded positive performance for the year.

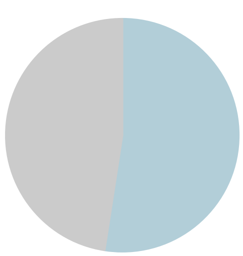
Value indices significantly outperformed growth indices in the US across all size ranges.

Small caps in the US outperformed large caps.

Ranked Returns for 2016 (%)



World Market Capitalization—US



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	12.74	8.43	14.67	7.07
Large Cap	12.05	8.59	14.69	7.08
Large Cap Value	17.34	8.59	14.80	5.72
Large Cap Growth	7.08	8.55	14.50	8.33
Small Cap	21.31	6.74	14.46	7.07
Small Cap Value	31.74	8.31	15.07	6.26
Small Cap Growth	11.32	5.05	13.74	7.76

** Annualized*

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International Developed Stocks

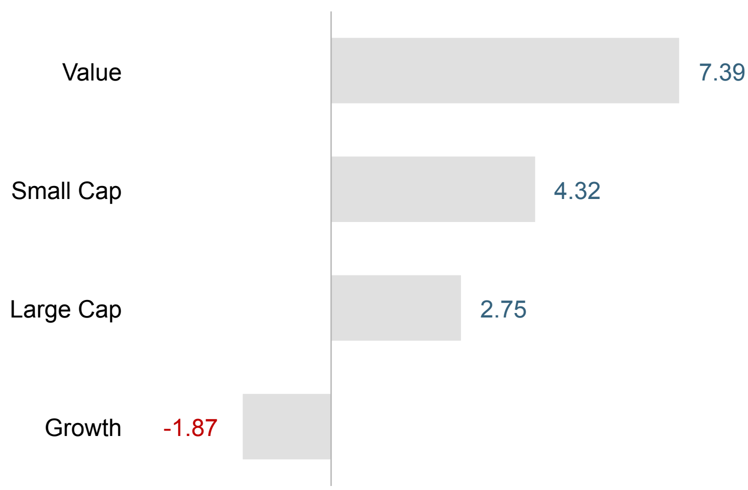
2016 Index Returns

In US dollar terms, developed markets outside the US lagged both the US equity market and emerging markets indices for the year.

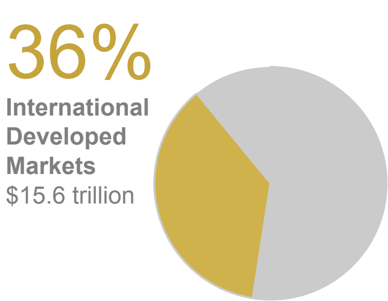
Small caps outperformed large caps in non-US developed markets.

Looking at broad market indices, the value effect was positive across all size ranges.

Ranked Returns for 2016 (%)



World Market Capitalization—International Developed



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	2.75	-1.59	6.07	0.86
Small Cap	4.32	1.36	8.96	2.69
Value	7.39	-2.12	5.96	0.08
Growth	-1.87	-1.18	6.08	1.56

** Annualized*

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Emerging Markets Stocks

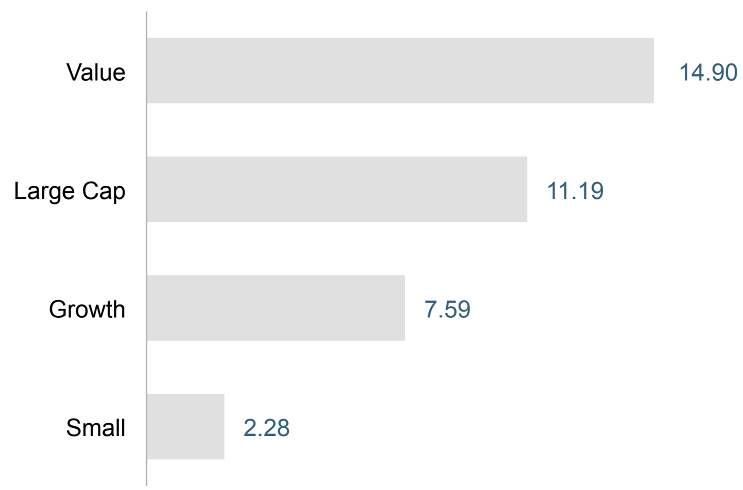
2016 Index Returns

In US dollar terms, emerging markets indices underperformed the US but outperformed developed markets outside the US for the year.

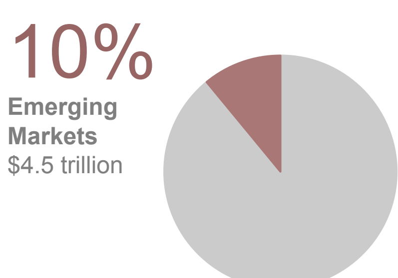
Looking at broad market indices, the value effect was positive across all size ranges.

Small caps underperformed large caps in emerging markets.

Ranked Returns for 2016 (%)



World Market Capitalization—
Emerging Markets



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	11.19	-2.55	1.28	1.84
Small Cap	2.28	-1.27	3.51	3.41
Value	14.90	-3.54	-0.27	1.97
Growth	7.59	-1.67	2.73	1.63

** Annualized*

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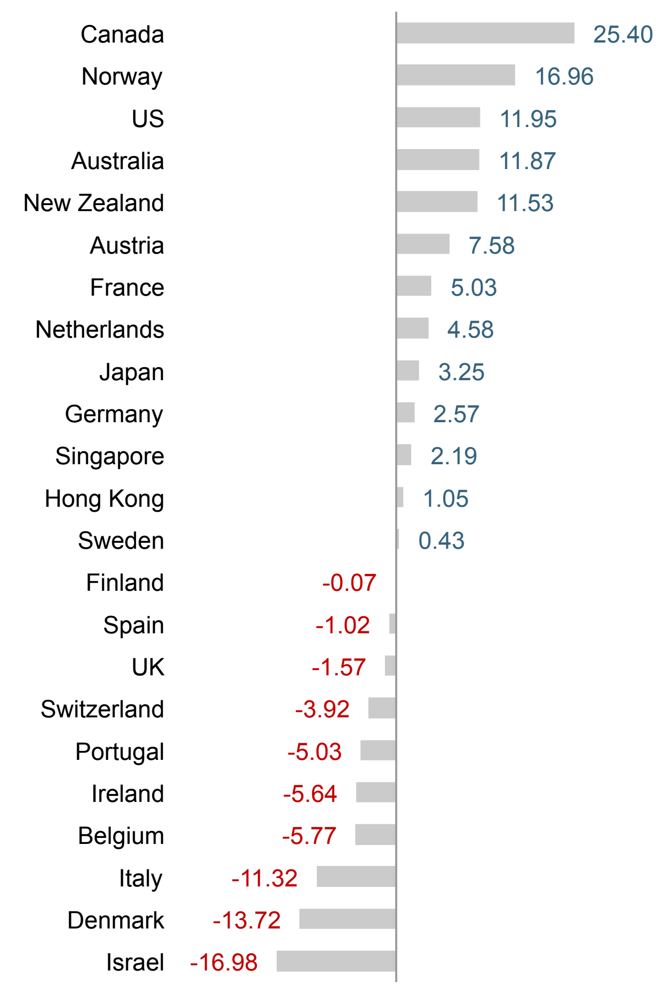
Select Country Performance

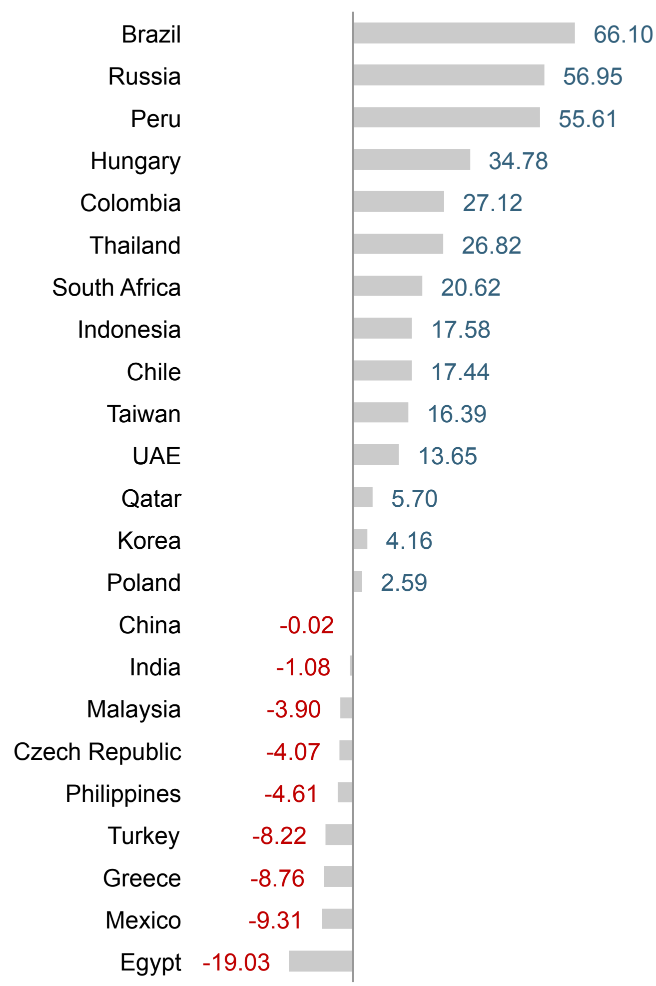
2016 Index Returns

Canada and Norway recorded the highest country performance in developed markets, while Israel and Denmark posted the lowest returns for the year. In emerging markets, Brazil and Russia posted the highest country returns, while Egypt and Mexico recorded the lowest performance.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)



Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), MSCI USA IMI Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. MSCI data © MSCI 2017, all rights reserved. UAE and Qatar have been reclassified as emerging markets by MSCI, effective May 2014.

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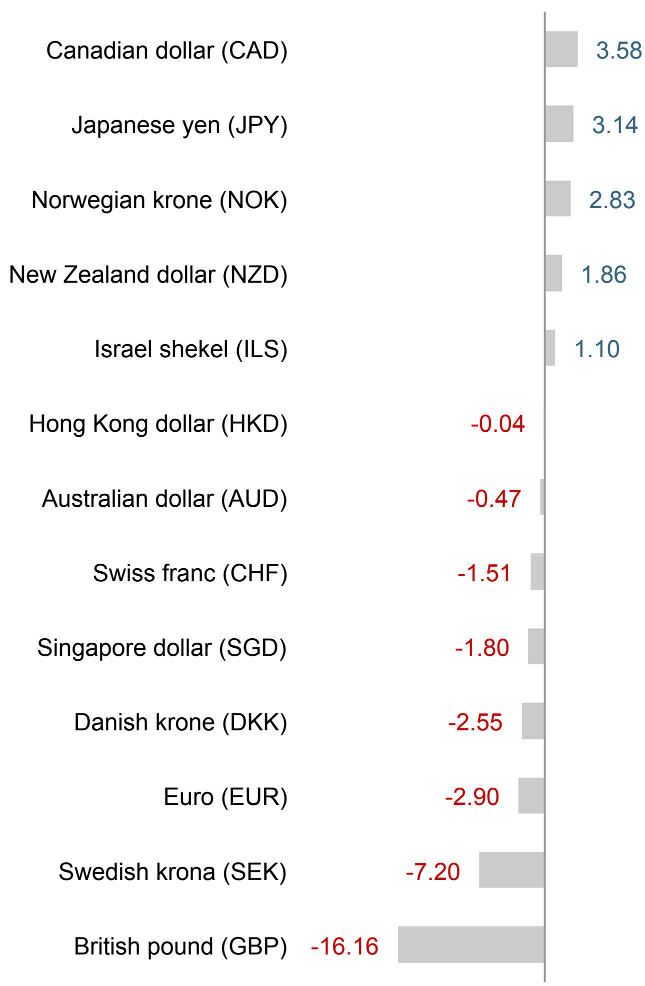
Select Currency Performance vs. US Dollar

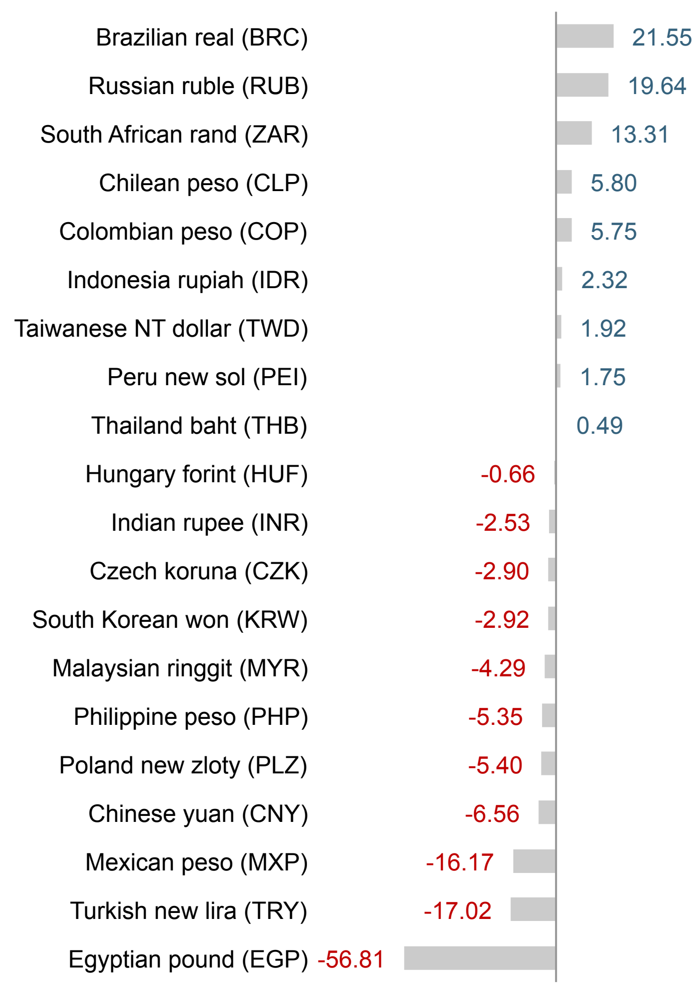
2016

Relative to the US dollar, currency returns were mixed for both the non-US developed and emerging markets. The best-performing currency in non-US developed markets was the Canadian dollar, while the British pound recorded the lowest performance. In emerging markets, the Brazilian real and the Russian ruble appreciated the most vs. the US dollar. The Egyptian pound lost more than half its value vs. the US dollar.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)



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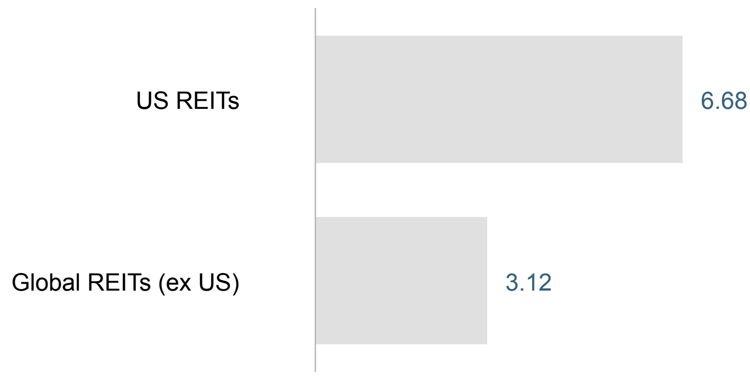
Real Estate Investment Trusts (REITs)

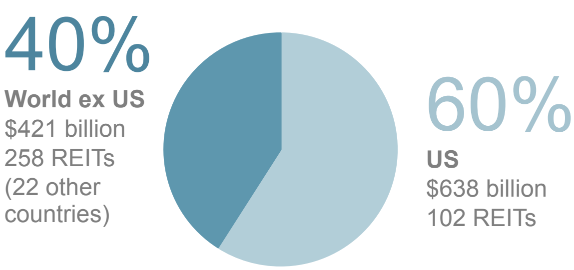
2016 Index Returns

US and non-US REITs had positive performance for the year but lagged the broad equity market in both regions.

Ranked Returns for 2016 (%)



Total Value of REIT Stocks



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
US REITs	6.68	13.73	11.77	4.63
Global REITs (ex US)	3.12	3.34	8.30	0.00

** Annualized*

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's Index Services Group © 2017.

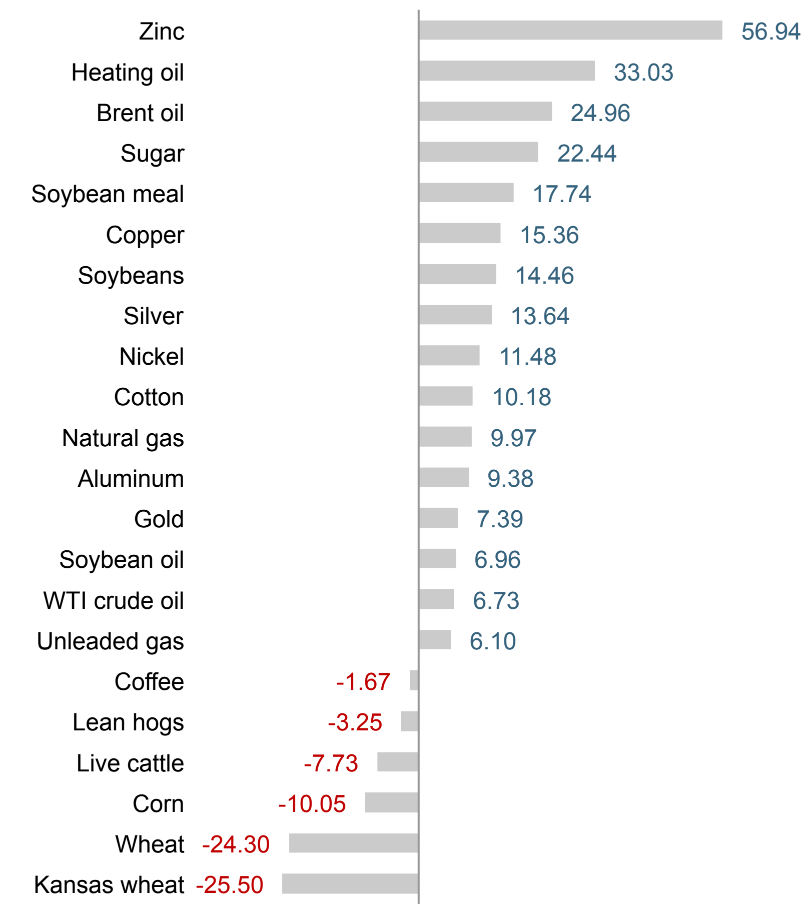
Commodities

2016 Index Returns

The Bloomberg Commodity Index Total Return gained 11.77% in 2016.

Zinc was the strongest performer, posting a return of 56.94%. Heating oil and Brent oil followed with respective returns of 33.03% and 24.96%. Kansas wheat was the weakest performer for the year, falling 25.50%.

Ranked Returns for Individual Commodities (%)



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
Commodities	11.77	-11.26	-8.95	-5.58

** Annualized*

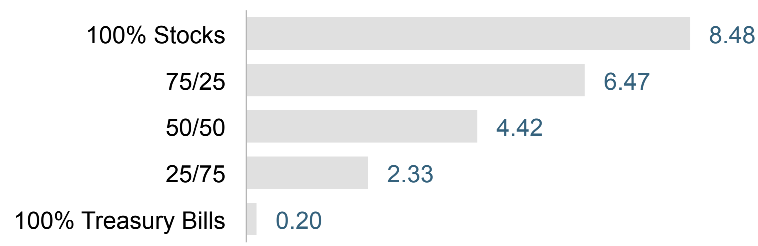
Past performance is not a guarantee of future results. Index is not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. All index returns are net of withholding tax on dividends. Securities and commodities data provided by Bloomberg.

Impact of Diversification

2016 Index Returns

These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Ranked Returns for 2016 (%)

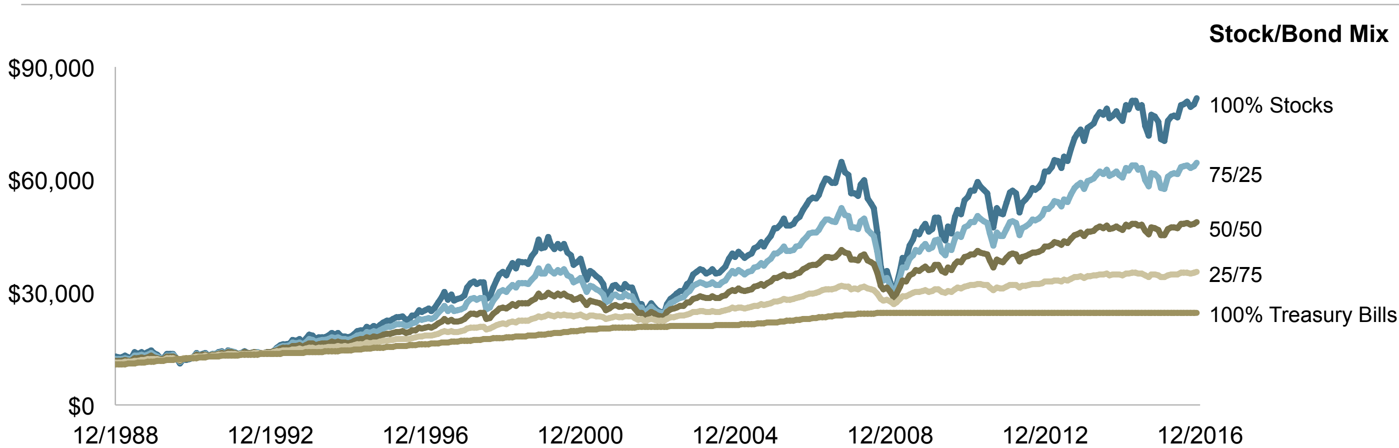


Period Returns (%)

** Annualized*

Asset Class	1 Year	3 Years*	5 Years*	10 Years*	10-Year STDEV[1]
100% Stocks	8.48	3.69	9.96	4.12	*16.9*
75/25	6.47	2.90	7.53	3.54	*12.7*
50/50	4.42	2.03	5.07	2.77	*8.5*
25/75	2.33	1.09	2.58	1.81	*4.2*
100% Treasury Bills	0.20	0.08	0.06	0.67	*0.4*

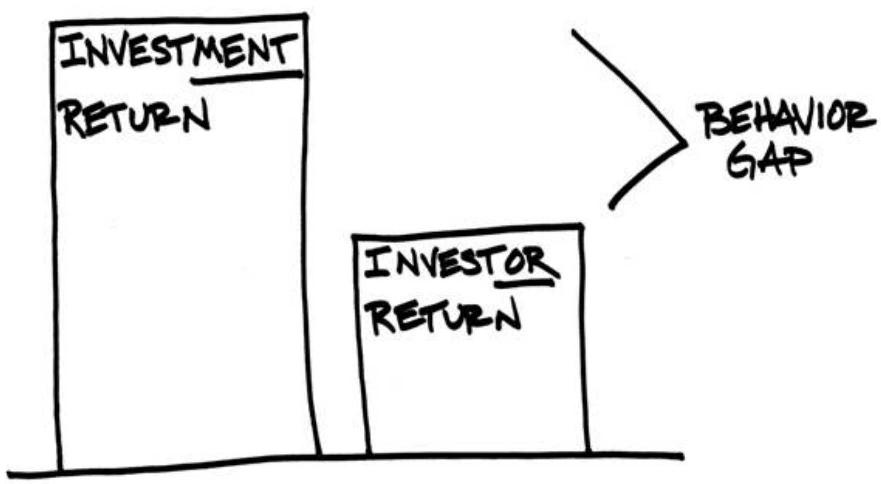
Growth of Wealth: The Relationship between Risk and Return



1. STDEV (standard deviation) is a measure of the variation or dispersion of a set of data points. Standard deviations are often used to quantify the historical return volatility of a security or portfolio.

Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2017, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

BEHAVIOR GAP



BEHAVIOR GAP

Professional Financial
Second Opinion Service

Exclusively for friends, family and colleagues of our valued clients

Paul Byron Hill, MBA MSFS MFP
Certified Financial Planner™ ©2017

PROFESSIONAL FINANCIAL
Integrative Wealth Management

In these volatile times, you probably know a friend, family member or colleague who may have a complicated situation, or who wonders whether they have the right financial advisor, or who just needs help, but doesn't get it. That's not uncommon. Studies suggest that over 80 percent of affluent investors would value a second opinion.*

In order to help those you care about achieve their financial goals, we have created our complimentary **Second Opinion Service**. We're pleased to offer your friends, family and colleagues the same expertise and guidance that you've come to expect as a valued client of Professional Financial.

Working with a team that redefines wealth management

Ask ten investors to define wealth management. Rather, ask ten typical "wealth managers" to do so. You'll almost certainly get ten different answers, and most replies will primarily focus only on investing. As a client of Professional Financial, however, you benefit from a team of CFPs® with a network of specialists sharing a different vision of comprehensive wealth management.

Our integrative process

At Professional Financial we approach each new engagement with a time-tested, collaborative process. This allows us to have an open dialogue with you so we can learn about your values and goals. This proven process enables us to work with you to tailor a plan that helps you meet your essential goals. As a valued client, you'll recognize each of the five steps below. As part of our **Second Opinion Service,** we offer a portion of our consultative service, complimentary, to you friends, family and colleagues.

WEALTH MANAGEMENT CONSULTING PROCESS

Step 1	Step 2	Step 3	Step 4	Step 5
Discovery meeting	Investment planning meeting	Mutual commitment meeting	Organizational meeting	Regular progress meetings

Professional Financial works with successful professionals and retirees, acting as their personal chief financial officer–meeting financial challenges of today and tomorrow, freeing them from many serious concerns. We steward wealth through a integrative process, helping families make informed decisions around preserving wealth, mitigating taxes, transferring wealth to heirs, protecting assets from unjust loss, and making a difference through charitable giving.

We integrate financial planning, investment management, and relationship consulting into a personalized process for each family. We employ a comprehensive approach to better understand our client's deepest needs, values and goals. We work closely with a network of experts in finance, accounting, tax and law. We accept as clients only those for whom we can make a major impact.

Founded in 1993, Professional Financial is an independent fee-only registered investment advisor staffed with Certified Financial Planners.™ As trusted advisors, we place client interests first. Professional memberships include: Financial Planning Association, American Institute of CPAs, Institute of Chartered Management Accountants, and National Association of Accountants.

PROFESSIONAL FINANCIAL
Integrative Wealth Management

What to expect from the Second Opinion Service

We will meet with your friends, family and colleagues for a discovery meeting and then invite them back for an investment planning meeting. Hopefully, we can confirm whether they are on track to achieve their goals with their existing financial providers. If appropriate, however, we'll suggest ways we can help, including recommending another qualified advisor if we're not a good fit for them. Either way, your family and friends will receive a Total Client Profile and a detailed analysis of their current investment portfolio and planning strategy—a value that may be in excess of $5,000.

SECOND OPINION SERVICE

Step 1	Step 2
Discovery meeting	Investment planning meeting

Integrative Wealth Management

Investment Management
- Wealth preservation
- Goal monitoring
- Risk analysis
- Portfolio structuring
- Manager due diligence
- Performance evaluation

Advanced Planning
- Wealth enhancement, including cash flow, tax minimization, and liability management
- Wealth transfer
- Wealth protection
- Charitable giving

Relationship Consulting
- Regularly scheduled calls, reviews and in-person meetings
- Network of specialists, including accounting, tax, actuarial, legal, insurance and financial resources

Let us help you help those you care about. Contact us today.

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*Source: Russ Alan Prince and David A. Geracioti, *Cultivating the Middle-Class Millionaire*, 2005.

Disclosure: Professional Financial Strategies, Inc. is an investment advisor registered with the Securities and Exchange Commission, and an independent, fee-only firm. A current firm disclosure brochure is available upon request by calling 585-218-9080.

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