Blankinship & Foster

Family Wealth Advisors

B&F PERSPECTIVES **FOURTH QUARTER 2016**

Quarter in Review

2016 proved to be tumultuous on many fronts. It began with a steep double-digit plunge in stock markets and ended with a six-week equity rally. Fears of rising interest rates, news surrounding oil prices and production cuts, and the political upsets of the Brexit vote and Donald Trump's victory in the U.S. presidential election spilled over into financial markets. Stocks (and to a lesser extent, bonds) saw wild swings in sentiment and prices as a result.

Amid the volatility, global stocks performed well. U.S. stocks again took the lead, with larger company stocks gaining 12.0% and small-cap stocks surging 21.3%. Developed international stocks gained just 1.0% for the year as strength in the dollar weighed on returns for U.S. investors. Our currency-hedged international strategy did considerably better: up 6.3% for the year. Emerging-market stocks rebounded strongly after a difficult 2015, gaining 11.2% this past year.

For the full year, the U.S. bond market gained 2.6%, but that hid a 3.0% tumble during the fourth quarter. Sharply rising interest rates produced the worst quarterly performance for bonds in 35 years. Bond losses were compounded by expectations for rising inflation and the Federal Reserve's December decision to raise overnight interest rates for the first time since August 2015. Short-term bonds held up better during the interest rate spike following the election, and high-yield bonds and other flexible fixed income strategies notched solid gains as well.

Asset Class	Index	Quarter	YTD	Last 12 Months	3 Years	5 Years
Stocks						
U.S. Large Cap Stocks	S&P 500 Index	3.8%	12.0%	12.0%	8.9%	14.7%
U.S. Mid Cap Stocks	Russell Midcap Index	3.2%	13.8%	13.8%	7.9%	14.7%
U.S. Small Cap Stocks	Russell 2000 Index	8.8%	21.3%	21.3%	6.7%	14.5%
Global Stocks	MSCI All Country World Index	1.2%	7.9%	7.9%	3.1%	9.4%
International Stocks	MSCI EAFE Index	-0.7%	1.0%	1.0%	-1.6%	6.5%
Emerging Markets Stocks	MSCI Emerging Markets	-4.2%	11.2%	11.2%	-2.6%	1.3%
Bonds						
Core U.S. Bonds	Bloomberg Barclay's Aggregate Bnd	-3.0%	2.6%	2.6%	3.0%	2.2%
Interm. Treasury Bonds	Bbg. Barclay's Intermediate Treas.	-2.3%	1.1%	1.1%	1.6%	1.0%
Short-term Bonds	Bbg. Barclay's 1-5 Yr Govt/Credit	-1.1%	1.6%	1.6%	1.3%	1.3%
Money Market/Cash	US 3 Month T-Bill	0.1%	0.3%	0.3%	0.1%	0.1%
Others						
Real Estate	DJ US Real Estate	-3.1%	7.6%	7.6%	11.8%	11.1%
Commodities	Goldman Sachs Commodity	5.8%	11.4%	11.4%	-20.6%	-13.1%

Source: Morningstar

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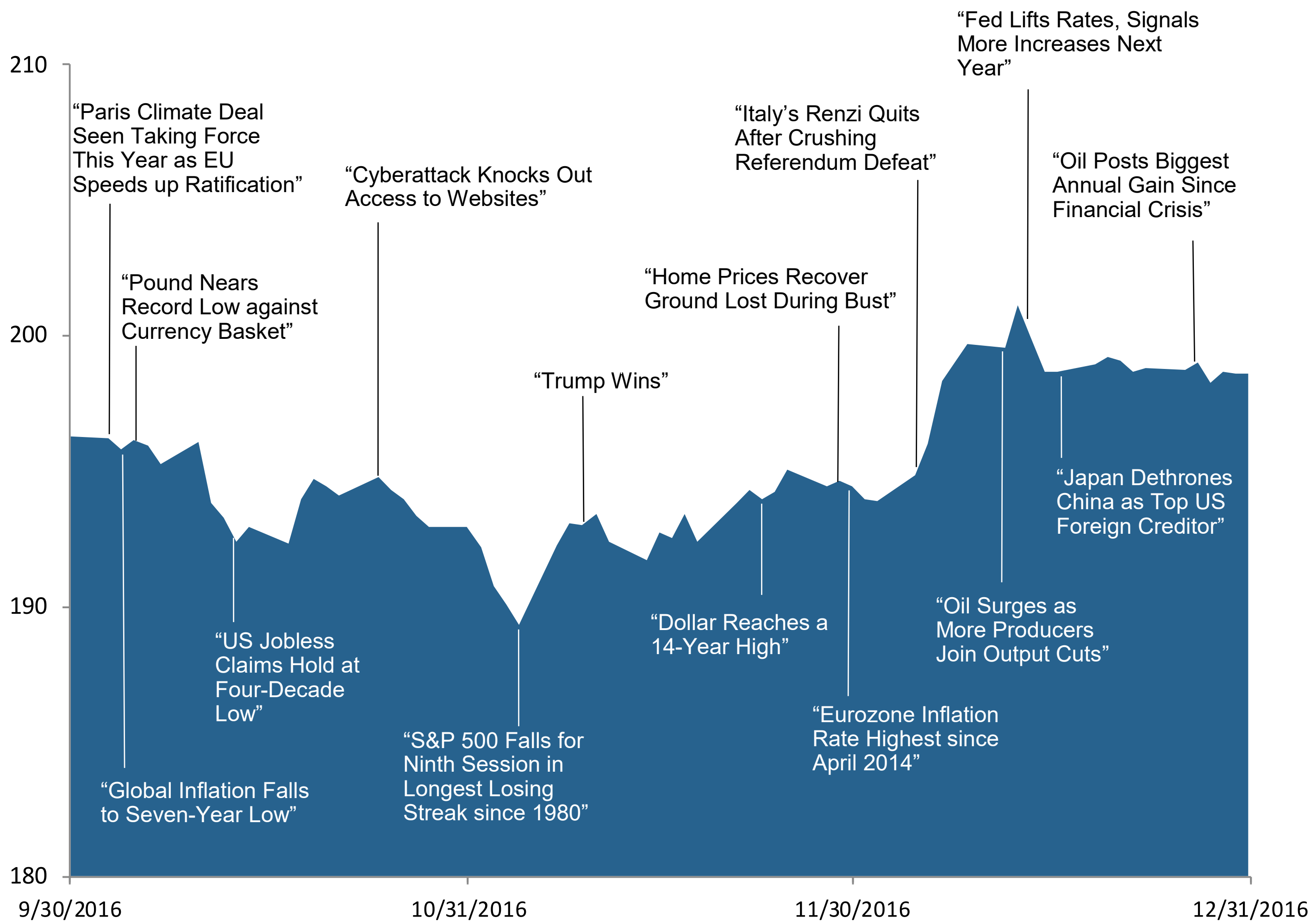
The chart below shows the change in global equity markets throughout the quarter. Juxtaposed over the market performance are some of the key events that occurred during the quarter. Sometimes as we get to the end of a volatile period, it's difficult to look back and remember everything that happened along the way.

Global Stock Market Performance

MSCI All Country World Index level with Selected headlines from the Quarter



Returns in US dollars. Graph Source: Dimensional Fund Advisors, Morningstar. It is not possible to invest directly in an index. Performance shown does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results. Selected headlines are not necessarily indicative of any impact they may or may not have had on the market.

Putting the markets' performance in perspective, we were pleased to see several of our convictions rewarded, especially against the backdrop of such a disconcerting year. Our portfolio positioning for rising interest rates performed as expected, and our stock portfolios performed well, too.

In constructing globally diversified portfolios, we know that there will be periods of time when comparisons to more concentrated portfolios or assets seem unfavorable. This is because diversification inherently mixes several assets together, some of which will be doing well and others struggling. But diversification remains the single most effective long-term risk mitigation tool. It also means gaining exposure to a wider set of investment opportunities, and sticking with them when our analysis convinces us of their favorable long-term return prospects. While some areas of the markets and our portfolios delivered strong performance this year, others were less robust. Since no one can predict ahead of time which market sectors will do well, or for how long, it pays in the long-run to own a wide selection of investments with attractive and differing risk and return drivers.

Where does this leave us? Looking forward, the direction of fiscal and monetary policy is anyone's guess. The new presidential administration and (to a lesser extent) Republican-controlled Congress have promised to roll back regulations, in addition to providing significant fiscal stimulus by increasing spending while cutting taxes. The markets have rallied strongly on this expectation, though it remains to be seen what actual policies will be delivered.

Given the Federal Reserve's plan to raise interest rates as a backdrop, it could mean higher debt servicing costs for both consumers and the government (i.e., taxpayers). Also, adding to net government spending when the economy is very close to full employment can put upward pressure on wages and inflation.

Rising interest rates and rising wages could weigh on corporations' future earnings, while corporate tax cuts and more stable energy prices could help support earnings in the near-term. With price-to-earnings multiples near historic highs, U.S. stocks appear overvalued compared to overseas companies.

After the post-election rally, it seems that quite a lot of positive news is already priced into stock markets today, leaving little room for disappointment. Thus we maintain our slight underweight to U.S. stocks, even though we recognize there is still potential for appreciation. Given the difference in valuations, and expected changes in monetary and fiscal policies both here and abroad, we expect international stocks to outperform U.S. stocks over the next few years.

While acknowledging that the year brings significant uncertainty for the investing environment, as well as with regard to potential tax law and other regulatory changes, we do continue to expect an upward drift in market interest rates, for all of the reasons stated above. If rates do continue rising, we also expect our diversifying strategies to outperform core investment grade bonds.

Lastly, we underscore the importance of viewing investment performance from the perspective of long-term wealth planning. This broader lens is critical in keeping you on track to meet your overall financial and life goals and in not overestimating the impact of any one quarter's, or even one year's, returns. We work closely with our clients both in building comprehensive wealth management strategies in addition to investment portfolios suited to their individual needs.

An Important Note About Your Reports

Beginning next quarter, we will be switching to a new, more advanced portfolio accounting system. As a result, the reports that we send to you each quarter will look very different. They will include many of the same components you receive today (asset allocation, performance, holdings, etc.) but the reports will be more colorful and contain additional features.

One significant difference is that our new system is much more accurate in its calculation of investment performance. The system we use today calculates monthly returns, whereas our new system will calculate portfolio performance every day. Thus, we expect that returns calculated by the two systems will be very similar, but we do not expect them to match exactly.

This is a significant upgrade to our technology and capabilities, and will allow us to automate some manual processes. In addition, it will lead to enhancements on our website including the ability to make some portfolio information available to you digitally.

We're excited to be rolling out this enhancement, and look forward to discussing these changes with you at our next meeting.