2015 in Review

JANUARY 2016

This time last year, we shared our satisfaction with the previous year's performance. We also cautioned that while a cursory review of economic factors appeared rosy, analysis revealed that the bulls might be running out of steam. We anticipated leaner days ahead:

> **In short, uncertainty is the dominant theme as we survey the economy. We note an increase in volatility but cannot say with certainty when, or to what extent, prices may fall.**

Accordingly, we positioned your portfolios for the inevitable bumpy ride.

Storm Preparations: We've Been Here Before

One of the most important services we provide to our clients is the discipline to stick with the plan, especially when the news is full of dramatic announcements about plunging domestic and international equity markets. We focus on managing risk according to your organization's needs and time horizon.

In January of 2015, we rebalanced all client portfolios to return portfolios to their target allocations and thus ensure that clients were not overexposed to equities relative to their objectives. In May, we increased the international equity allocation in clients' portfolios because several measures indicated that domestic equities had become overvalued. At that time, international equities had underperformed domestic equities in four of the past five years—so we sold some winning positions to buy more losers. These seemingly odd moves accomplished two important goals: First, they returned portfolio allocations to the objectives that we had determined based on each client's needs. Second, they cashed in on the gains that domestic equities had achieved in 2013 and 2014. The strong U.S. dollar, now nearly on par with the euro, has reduced international equity returns for U.S.-based investors.

In the fixed income segment, we continue to maintain a short duration to offset the effects of possible rising interest rates. We are, however, increasingly concerned about the risk of the global recession slipping into depression and deflation, in which case we could adjust fixed-income positions. We slightly increased client positions in high-yield bonds as they have become more attractive. Additionally, we have retained a small allocation to Treasury Inflation-Protected Securities (TIPS) in case inflation should increase more than expected.

Although gold will do poorly in the short term if the dollar continues to appreciate against other currencies, we maintain a small position in precious metals because it helps protect against long-run price inflation and the uncertainty associated with global currency in this environment. If short-term interest rates increase in the U.S. and other countries keep their rates low, the dollar's value may rise further and gold has historically done poorly in a strong dollar environment. We remain convinced that a small allocation to gold is worthwhile as a hedge against the potential weakening of the dollar.

TOWNELEY CAPITAL MANAGEMENT INC
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Behind the Scenes, We're Working For You

Serving as your investment advisor is one of those jobs that, when done well, looks effortless. But a lot of activity takes place "backstage." We believe that's why you hired us—to manage the intricacies of caring for your organization's wealth and help your board and committee members fulfill their fiduciary obligations.

Here are some of the investment management decisions we implemented for our clients in 2015:

Strategic Rebalancing

We conduct a firm-wide rebalance based on our economic views and research. We did this twice last year. In January, we rebalanced to take gains in domestic equities. In May, we rebalanced to increase international equity and decrease domestic equity, thus confirming that client portfolios were returned to the proper allocation for the client's risk tolerance. We added a small increment to high-yield exposure, bought TIPS with a longer duration, and decreased international fixed income.

Cash Flow Rebalancing

We meet clients' cash flow needs by raising cash when a client needs a withdrawal and trading to invest incoming funds. These trades are based on our evaluation of the specific portfolio's unique positions at the time.

Fiduciary Support

Board and investment committee members are fiduciaries and the requirements of prudent stewardship can resemble a tangled knot. Our Fiduciary Edge™ helps keep you on track to fulfill your responsibilities and document the results. We also shoulder some of the fiduciary burden for your organization's investment stewards, reducing their personal exposure.

Investment Policy Statement (IPS)

We conducted periodic reviews of several clients' IPSs and drafted revisions as appropriate. Since this document specifies the key policies and procedures of managing and overseeing your investment portfolios and activities, keeping it current is crucial.

Meetings

We attended many client board or committee meetings either in person or via conferencing technology and prepared reports and analyses for these and other meetings. Throughout the year we responded to several requests for ad hoc analyses or recommendations.

Ongoing Services

Throughout the year, we analyze domestic and international equity and bond markets, commodities, economies, fund managers, the evening news, and any other factors that influence the management of your portfolio. We do not chase performance, as returns are beyond our control. Instead we manage risk, ensuring that client portfolios are positioned in alignment with each organization's unique needs.

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Beyond Investment Management

As your trusted wealth care advisor, we helped clients answer important questions like these in 2015:

- **Are we taking on the right amount of risk?** The "right" amount of risk depends on factors like whether your organization plans to "live forever," timelines of anticipated need of the assets in the portfolio and details of your IPS.
- **Are we spending too much? Can we spend more?** We lend our expertise to your consideration of budgetary decisions. We can lay out various scenarios and possible outcomes for your board to review.
- **Are we saving enough to carry the organization through tough times?** Especially if your revenue depends on sources that may vary widely from one year to another, it's important to have a good feel for how much to have in reserves. We can analyze various scenarios and provide our recommendations.
- **Should we buy the building that houses our offices?** Owning your own building offers a nice sense of permanence, but it may not be the best financial move. We evaluate these situations and walk you through your options.
- **Can you help explain our investment positioning to our Board of Directors?** From time to time, board members don't fully grasp the nuances of the organization's investment strategy and the investment committee's activities. If documenting committee decisions in a dossier for your board would be helpful, we'll happily do so.

Towneley News For You

- You may receive a telephone call or email from Portfolio Management Associate Chris Gardner as he assumes more client service duties here at Towneley. Chris has passed the Series 65 (Uniform Investment Advisors Law) exam and is now a registered investment advisor representative with Towneley.
- If you have contact with Director of Fiduciary Services Robyn Bahlinger, you will soon be seeing emails from Robyn Clarke. She and J.C. Clarke tied the knot in snowy Lake Arrowhead, California on January 16. We extend our best wishes to the newlyweds.
- You may have noticed our fresh new look and logo. Stay tuned for more changes and exciting new ways we can help you.

Thoughts from Towneley

The drawdown we had anticipated appears to be underway. 2015 returns were nearly flat, and the first weeks of 2016 have brought steep drops in several markets across the globe. China's financial crisis will impact demand for U.S. exports. Domestic corporate profits have slid. Employment figures look promising—until one factors in the number of discouraged workers who have left the arena. Collapsing oil prices induce a ripple effect across markets.

Steep market drops tend to make everyone queasy. We ask you to remember three important points: First, we're always looking for the opportunities that arise from market dislocations. Second, if you have experienced, or anticipate, a change in revenues, spending needs, major expenditures, or any other significant event, please contact your portfolio manager right away. That information is vital to properly managing risk in your portfolios. Finally, since 96% of market gains occurred during 0.9% of trading days between 1963 and 2004, remaining in the market during turbulent times is the right course.