TOWNELEY CAPITAL MANAGEMENT INC
ESTABLISHED 1971

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 needs and risk tolerance.

In January of 2015, we rebalanced all client portfolios to return them 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 and risk tolerance. 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.

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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 wealth, freeing you to do what you do best.

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.

Tax Losses

In December we harvested tax losses for clients who would benefit from them, resulting in potential tax savings.

Ongoing Services

Throughout the year, we analyze domestic and international equity and bond markets, commodities, economies, fund managers, the evening news, and other factors that influence the value 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 the client's risk tolerance.

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Beyond Investment Management

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

- **Am I on track to retire as I planned?** Tell us when you plan to retire and what retirement lifestyle you envision. We will determine if you're on track and consult with you regarding best strategies to achieve your goals.
- **When we look at everything we have—our home, our 401(k)s, our Towneley accounts—are we well-positioned?** We prepare a review of your assets, showing your total allocation across all asset classes. Pulling this information together into a single document provides a clear picture of how well-diversified your holdings are and whether your assets align with your risk tolerance.
- **Am I taking on the right amount of risk?** The "right" amount of risk depends on factors like how soon you expect to need the assets you have invested and your personal comfort level. Since we want our clients to sleep well at night, we have tools to help manage your investments based on your risk tolerance.
- **How much of my money can I spend each year?** If you'd like to know how long your money will last, we can provide you with an assessment. We help you develop a spending plan to maintain your lifestyle.
- **Are we saving enough to put the kids through college?** If you want to pay for a child's or grandchild's higher education, we can outline a plan to help you reach that goal.
- **Can you talk with my accountant about tax planning?** Yes. In fact, we have seen that our partnership with your accountant, attorney, and other wealth care professionals enhances your financial results.

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.
- Along with your quarterly reporting, we have enclosed the Contributions, Withdrawals, and Expenses report. It provides information that may be relevant for tax reporting. TD Ameritrade will furnish realized gains and losses and 1099s directly to you.
- 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 your health, income, expenses, retirement plans, or any other significant life 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.