Fourth Quarter 2016

GALECKI FINANCIAL MANAGEMENT — FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	0.02%	3.85%	7.84%
Russell Midcap Index	0.20%	4.52%	10.26%
Russell 2000 Index	1.11%	9.05%	11.46%
Dow Jones Industrial Average	-0.41%	2.78%	7.21%
Morgan Stanley EAFE Index	1.23%	6.43%	1.73%
MSCI US REIT Index	-1.83%	-1.45%	11.91%
DJ UBS Commodity Index	3.13%	-3.86%	8.87%
Barclays Aggregate Bond Index	-0.06%	0.46%	5.80%

INDEX RETURNS

The third quarter produced solid gains for most major markets around the world. The volatility from the British exit vote to leave the European Union subsided. The price of oil has settled into a nice range of $45 - $50. The U.S. Dollar has paused itôs appreciation versus other major currencies, relieving pressure on many U.S. companies.

U.S. Large cap stocks ended the quarter up 3.85% following a 2.5% gain in the 2nd quarter. The S&P 500 is now up 7.84% on the year. Value stocks have outperformed growth stocks this year with the Russell 3000 Value index posting a 10.4% gain while the Russell 3000 Growth Index is only up 6.12%.

Mid-cap stocks and small-cap stocks both had a strong third quarter by advancing 4.52% and 9.05% respectively. On the year, Mid cap stocks are up 10.26% and Small cap stocks are up 11.46%. Real Estate and Commodities both regressed in the third quarter with real estate dropping 1.45% while commodities declined 3.86%.

The bond market was quiet over the last three months with the Barclays Aggregate Index increasing 0.46%. Overall, this index is now up 5.80% on the year.

ECONOMIC REVIEW AND OUTLOOK

The economy grew at a 1.4% annualized rate in the second quarter of this year. This followed the 0.8% growth rate in the first quarter. Early estimates for the third quarter are in the 2.0-3.0% range. The GDP growth rate in the United States has averaged 3.22% per year from 1947 through 2016. The expansion that began in June of 2009 has brought an average GDP growth rate of only 2.1% per year. While this economic expansion has now lasted almost 7 ½ years, (which is twice as long as the average expansion) the cumulative real GDP growth is still relatively low compared to prior expansions.

GALECKI FINANCIAL MANAGEMENT
1990-2015 25 YEARS

The Leading Economic Index declined 0.2% in August to 124.1 following a 0.5% increase in July and a 0.2% increase in June. These numbers suggest that the economy will continue to grow at a slow-moderate pace over the next few quarters. Industrial Production decreased 0.4% in August after increasing 0.6% in July and the Capacity Utilization rate dropped to 75.5 percent. This is 4.5 percentage points below the historical average over the last forty years and suggests that there will not be much pricing pressure in manufacturing over the next few quarters.

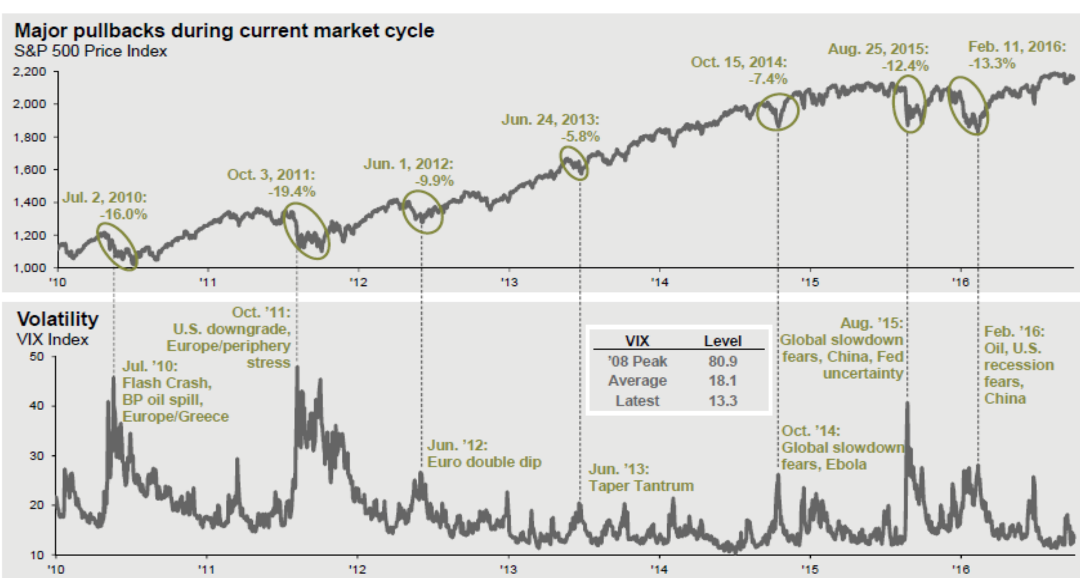
Non-farm payrolls increased by 151,000 in August and the unemployment rate is at 4.9%. Initial weekly unemployment claims were 254,000 for the week ending September 24. According to the JOLTS survey, there were 5.9 million job openings in July. Average hourly earnings increased to $25.73 with a year-over-year increase of 2.4%. American workers should continue to see decent wage growth with this tight labor market.

Manufacturing dipped in August to a reading of 49.4 percent on the ISM PMI. The September reading came in at 51.5% which is back in expansion territory. The ISM Non-Manufacturing index fell 4.1 points to 51.4 percent in August. This is the lowest reading since February of 2010 and is worth watching over the next few months.

Global economies are improving. The JP Morgan Global PMI is at 51.0 in September up from 50.4 in June. The Euro area is at 52.6 lead by Germany who was at 54.3 percent in September. Emerging markets are improving but are still at 49.8 percent in August which is up from 49.5 percent in May.

EQUITY AND BOND MARKETS

Market volatility was benign for an extended period of time. Prior to August of 2015, it had been four years since the S&P 500 experienced a 10% correction. The 12.4% pullback in August of last year was due mainly to global slowdown fears, China and the Federal Reserve. The first six weeks of this year brought a 13.3% correction as the market worried about collapsing oil prices and a potential U.S. recession. The chart below shows that we had seven corrections going back to 2010. In each case, the market eventually recovered and moved higher. This is an important lesson as we move into this presidential election in November. Volatility is likely to increase, but we must keep a long term focus and ignore the short term corrections.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) CBOE.
Drawdowns are calculated as the prior peak to the lowest point.
Guide to the Markets – U.S. Data are as of September 30, 2016.

Earnings in the U.S. are improving and valuations are holding steady. The P/E ratio for the S&P 500 is around 16.6 which is slightly above the 25 year average. Developed International markets are trading at 15.9 times their earnings which is right at the 25 year average. Emerging markets are trading at 1.5 times their book value which is below the 25 year average of 1.7 times book value. Although we expect market volatility will increase in the fourth quarter, solid fundamentals should keep the downside correction risk in the 5-10% range.

The Federal Reserve is expected to raise interest rates in December by 0.25%. The yield on the 10 Year U.S. Treasury is around 1.7%. With 71% of government bonds outside of the U.S. yielding less than 1% and 33% have yields that are actually negative, our yield of 1.7% looks attractive. This means that global demand for our government bonds should stay strong which will keep the long end of the yield curve where it is. The Federal Reserve will be very careful about raising short term rates too quickly as they will not want to invert the yield curve (short term yields would be higher than long term yields in an inverted scenario). Historically that has been a reliable indicator for an upcoming recession and the Fed would like to avoid that scenario.

PORTFOLIO MANAGEMENT

We began the year with a very defensive allocation that consisted of a large cash position. The market's reaction to the BREXIT vote created an opportunity for us to put that cash back to work. We were able to purchase the American Century Equity Income fund at a time when it was pretty cheap. This impacted our rate of return greatly and caused our large cap performance to significantly outperform the S&P 500 on the year.

At this point, the portfolio is fully invested. However, our current allocation reveals a somewhat defensive underlying tone. We have kept our domestic small-cap and mid-cap exposure down all year. Our large-cap exposure is heavy, but with funds that have historically had very good downside capture ratios. Invesco Diversified Income Fund, Vanguard Dividend Growth Fund and American Century Equity Income fund should all perform well relative to the S&P 500 if a market correction occurs.

We sold our Salient MLP and Energy fund after it was up more than 20% this year. The volatility in this fund is more than we were comfortable with for our clients. Meanwhile, the Global Real Estate fund has had a great year and continues to pay a nice dividend. On the bond side of the portfolio, our Market Neutral fund is up nearly 5% while we are also seeing nice returns from our short-term bonds, high-yield bonds and global bonds.

FINANCIAL PLANNING

Required Minimum Distributions must be completed by December 31, 2016. For individuals over age 70 ½, please make sure that you satisfy the RMD for the year. The penalty for not taking the full amount is 50% on the shortfall. Congress has made permanent the Qualified Charitable Deduction for those individuals over age 70 ½. This allows direct contributions to charities from your IRA to qualify as your RMD. This is a great way to give to charity and reduce your Adjusted Gross Income, thereby lowering your tax liability.

The deadline to make your 2016 Indiana 529 Plan contribution is approaching. Contributions must be received by the plan provider by December 31, 2016. A $5,000 contribution to your Indiana 529 Plan will enable you to receive a $1,000 state tax credit. That is a 20% rate of return! Visit www.collegechoicedirect.com for more information.

There is still time to do some tax planning for 2016. Should you convert some of your Traditional IRA assets to a Roth IRA this year? If you are under age 70 ½, this could be an effective strategy. You will pay taxes on the amount that you convert, but this will reduce your future distributions at potentially higher tax brackets. To see how much you should convert this year, contact Andy Young, CPA at andy@galecki.com. Maximizing your tax brackets in retirement can save you thousands of dollars down the road.

Here are some smart phone apps that we think you might enjoy. Please let us know if you have any new apps that you would like to share with everyone.

- **18 Birdies**: This application is a great application for golfers. The app offers GPS viewing for almost every golf course. Know distances to the green or other hazards on the course. Connect with friends through the interactive social experience. The application is free on most platforms.
- **Cash**: This application allows you to pay your friends or have them pay you instantly from their bank account or debit card. There is no fee to send or receive cash. It is a free application.
- **Google Search:** The new Google Search app allows you to search almost anything. Say, ñOk Googleò and find everything from nearby restaurants to the calories in your meal. The quickest way to find answers to almost any question. Google also shows you information that you need before you ask, like sports alerts or traffic updates. This application is free.

Company News

Making Strides Agains Breast Cancer Walk

Making Strides Against Breast Cancer walks are the largest network of breast cancer awareness events in the nation. Passionate walk participants raise critical funds that enable the American Cancer Society to fund innovate research; provide free, information and support to anyone touched by breast cancer, and help reduce their breast cancer risk. They are currently funding more than $74 million in breast cancer research through 185 research and training grants.

Galecki Financial Management has been a proud supporter of this event (and our very own Becky). The October 15th walk will represent the 6th year that we have been a part of this event. We feel blessed to have Becky on our team and in our lives and hope we can all make a small difference in the fight against breast cancer.
- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com.