First Quarter 2017

GALECKI FINANCIAL MANAGEMENT

FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	1.98%	3.82%	11.96%
Russell Midcap Index	1.14%	3.21%	13.80%
Russell 2000 Index	2.80%	8.83%	21.31%
Dow Jones Industrial Average	3.44%	8.66%	16.50%
Morgan Stanley EAFE Index	3.42%	-0.71%	1.00%
MSCI US REIT Index	4.69%	-2.96%	8.60%
DJ UBS Commodity Index	1.80%	2.66%	11.77%
Barclays Aggregate Bond Index	0.14%	-2.98%	2.65%

INDEX RETURNS

The fourth quarter surprised many analysts with an impressive rally following the U.S. presidential election. Although some of the gains appear to be due to a ñTrump Bumpò, earnings in the U.S. were improving nicely in the months prior to the election.

U.S. Large cap stocks ended the quarter up 3.82% following a 3.85% gain in the 3rd quarter. The S&P 500 gained 11.96% on the year. Value stocks significantly outperformed growth stocks this year with the Russell 200 growth index increasing 6.95% vs. 17.4% for the Russell 200 value index.

Mid cap stocks and small cap stocks both had great returns in 2016. Mid cap stocks finished up 13.80% and small cap stocks were up 21.31% on the year. Real Estate and Commodities also had solid returns over the last 12 months with gains of 8.6% and 11.77% respectively.

The bond market was quiet over the last three months with the Barclays Aggregate Index increasing 0.14%. Overall, the bond index was up 2.65% in 2016.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy grew at a 3.5% annualized rate in the third quarter. This followed the 1.4% growth rate in the second quarter. Early estimates for the fourth quarter are in the 1.0-1.5% range. The third quarter growth rate was the highest in the last two years as personal consumption and government expenditures rose faster than anticipated and exports were boosted by a boom in soybean shipments. GDP growth has averaged 3.23 percent from 1947 through 2016.

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1990-2015 25 YEARS

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The Leading Economic Index was unchanged in November at 124.6 following a 0.1% increase in October and a 0.3% increase in September. 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 November after increasing 0.1% in October and the Capacity Utilization rate dropped to 75.0 percent. This is 5.0 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 178,000 in November and the unemployment rate is at 4.6%. Initial weekly unemployment claims were 254,000 for the week ending September 24. According to the JOLTS survey, there were 5.5 million job openings in October. Average hourly earnings increased to $25.89 with a year-over-year increase of 2.5%. American workers should continue to see decent wage growth with this tight labor market.

Manufacturing increased in December to a reading of 54.7 percent on the ISM PMI. The November reading came in at 53.2% which is still in expansion territory. The ISM Non-Manufacturing increased by 2.4 points to 57.2 percent in November. This is the highest reading over the last 12 months and suggests the economy should continue to grow. The Business Activity Index was at 61.7% and the New Orders Index was at 57.0%.

Global economies continue to improve. The JP Morgan Global PMI is at 52.7 in December up from 51.0 in September. The Euro area is at 54.9 lead by Germany and Ireland who are at 55.6 and 55.7 respectively. Emerging markets are showing renewed life with a November reading of 50.6 lead by Taiwan and Russia.

EQUITY AND BOND MARKETS

Domestic stock returns were impressive again in 2016. A fair amount of the returns occurred in the last quarter of the year with small cap stocks leading the way at 11.13% over the final three months. Even large cap stocks rose an impressive 3.82% in the final quarter. Where do we go from here? What will 2017 bring for equity returns?

Domestic earnings have rebounded nicely over the last six months. The major headwinds of depressed oil prices and a surging U.S. Dollar have subsided clearing the path for earnings growth. In fact, even after this impressive fourth quarter rally, the S&P 500 is still trading at a P/E ratio of only 17.2 times earnings. This is only slightly higher than the 25 year average.

Global Purchasing Managers' Index for manufacturing

	Jan'15	Feb'15	Mar'15	Apr'15	May'15	Jun'15	Jul'15	Aug'15	Sep'15	Oct'15	Nov'15	Dec'15	Jan'16	Feb'16	Mar'16	Apr'16	May'16	Jun'16	Jul'16	Aug'16	Sep'16	Oct'16	Nov'16	Dec'16
Global	51.6	51.8	51.5	50.8	51.1	50.9	50.8	50.5	50.4	51.1	51.0	50.7	50.9	50.0	50.6	50.2	50.1	50.4	51.0	50.8	51.0	52.0	52.1	52.7
Developed Markets	52.5	52.8	53.0	52.1	52.4	52.1	52.5	52.4	52.1	53.0	52.6	52.0	52.3	50.9	50.9	50.4	50.2	50.9	51.5	51.3	51.6	52.8	53.2	-
Emerging Markets	50.8	50.9	49.8	49.3	49.5	49.2	48.8	48.3	48.3	48.9	49.1	49.2	49.2	48.8	50.0	49.5	49.5	49.3	50.1	49.9	50.0	50.7	50.6	-
U.S.	53.9	55.1	55.7	54.1	54.0	53.6	53.8	53.0	53.1	54.1	52.8	51.2	52.4	51.3	51.5	50.8	50.7	51.3	52.9	52.0	51.5	53.4	54.1	54.3
Canada	51.0	48.7	48.9	49.0	49.8	51.3	50.8	49.4	48.6	48.0	48.6	47.5	49.3	49.4	51.5	52.2	52.1	51.8	51.9	51.1	50.3	51.1	51.5	51.8
UK	52.6	54.0	53.7	52.3	52.1	51.5	52.2	51.7	51.5	54.8	52.6	51.4	52.7	50.7	51.0	49.7	50.5	52.4	48.2	53.4	55.5	54.6	53.6	56.1
Euro Area	51.0	51.0	52.2	52.0	52.2	52.5	52.4	52.3	52.0	52.3	52.8	53.2	52.3	51.2	51.6	51.7	51.5	52.8	52.0	51.7	52.6	53.5	53.7	54.9
Germany	50.9	51.1	52.8	52.1	51.1	51.9	51.8	53.3	52.3	52.1	52.9	53.2	52.3	50.5	50.7	51.8	52.1	54.5	53.8	53.6	54.3	55.0	54.3	55.6
France	49.2	47.6	48.8	48.0	49.4	50.7	49.6	48.3	50.6	50.6	50.6	51.4	50.0	50.2	49.6	48.0	48.4	48.3	48.6	48.3	49.7	51.8	51.7	53.5
Italy	49.9	51.9	53.3	53.8	54.8	54.1	55.3	53.8	52.7	54.1	54.9	55.6	53.2	52.2	53.5	53.9	52.4	53.5	51.2	49.8	51.0	50.9	52.2	53.2
Spain	54.7	54.2	54.3	54.2	55.8	54.5	53.6	53.2	51.7	51.3	53.1	53.0	55.4	54.1	53.4	53.5	51.8	52.2	51.0	51.0	52.3	53.3	54.5	55.3
Greece	48.3	48.4	48.9	46.5	48.0	46.9	30.2	39.1	43.3	47.3	48.1	50.2	50.0	48.4	49.0	49.7	48.4	50.4	48.7	50.4	49.2	48.6	48.3	49.3
Ireland	55.1	57.5	56.8	55.8	57.1	54.6	56.7	53.6	53.8	53.6	53.3	54.2	54.3	52.9	54.9	52.6	51.5	53.0	50.2	51.7	51.3	52.1	53.7	55.7
Australia	49.0	45.4	46.3	48.0	52.3	44.2	50.4	51.7	52.1	50.2	52.5	51.9	51.5	53.5	58.1	53.4	51.0	51.8	56.4	46.9	49.8	50.9	54.2	55.4
Japan	52.2	51.6	50.3	49.9	50.9	50.1	51.2	51.7	51.0	52.4	52.6	52.6	52.3	50.1	49.1	48.2	47.7	48.1	49.3	49.5	50.4	51.4	51.3	51.9
China	49.7	50.7	49.6	48.9	49.2	49.4	47.8	47.3	47.2	48.3	48.6	48.2	48.4	48.0	49.7	49.4	49.2	48.6	50.6	50.0	50.1	51.2	50.9	51.9
Indonesia	48.5	47.5	46.4	46.7	47.1	47.8	47.3	48.4	47.4	47.8	46.9	47.8	48.9	48.7	50.6	50.9	50.6	51.9	48.4	50.4	50.9	48.7	49.7	49.0
Korea	51.1	51.1	49.2	48.8	47.8	46.1	47.6	47.9	49.2	49.1	49.1	50.7	49.5	48.7	49.5	50.0	50.1	50.5	50.1	48.6	47.6	48.0	48.0	49.4
Taiwan	51.7	52.1	51.0	49.2	49.3	46.3	47.1	46.1	46.9	47.8	49.5	51.7	50.6	49.4	51.1	49.7	48.5	50.5	51.0	51.8	52.2	52.7	54.7	56.2
India	52.9	51.2	52.1	51.3	52.6	51.3	52.7	52.3	51.2	50.7	50.3	49.1	51.1	51.1	52.4	50.5	50.7	51.7	51.8	52.6	52.1	54.4	52.3	49.6
Brazil	50.7	49.6	46.2	46.0	45.9	46.5	47.2	45.8	47.0	44.1	43.8	45.6	47.4	44.5	46.0	42.6	41.6	43.2	46.0	45.7	46.0	46.3	46.2	45.2
Mexico	56.6	54.4	53.8	53.8	53.3	52.0	52.9	52.4	52.1	53.0	53.0	52.4	52.2	53.1	53.2	52.4	53.6	51.1	50.6	50.9	51.9	51.8	51.1	50.2
Russia	47.6	49.7	48.1	48.9	47.6	48.7	48.3	47.9	49.1	50.2	50.1	48.7	49.8	49.3	48.3	48.0	49.6	51.5	49.5	50.8	51.1	52.4	53.6	53.7

Source: Markit, J.P. Morgan Asset Management.
Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown. Japan December manufacturing PMI is a flash estimate.
Guide to the Markets – U.S. Data are as of December 31, 2016.

Equity valuations outside of the U.S. look even more compelling. The P/E ratio for Developed International markets is at 16.4 times earnings and emerging markets are trading at a price-to-book ratio of only 1.4 versus their long term average of 1.7. The chart above shows the Global Purchasing Manager's Index for manufacturing. Green shaded boxes represents improving data, while red boxes show deteriorating conditions. You can see clearly that manufacturing activity around the globe is improving nicely. The U.S. is not the only country doing well. The U.K., Germany, France, Italy, Spain, Ireland, Australia, Taiwan and Russia are all growing impressively. It is possible that we will see market returns outside of the U.S. return to the top.

The Federal Reserve increased the Fed Funds target short term rate in December by 25 basis points to 0.75%. They also provided guidance that suggests three more hikes could occur in 2017. This caused bond yields to rise over the last few months with the 10-year U.S. Treasury yield now hovering around 2.4%. Additional rate hikes will continue to put pressure on existing bond holders. It will be important to keep duration low during this rate hike cycle.

PORTFOLIO MANAGEMENT

Our investment committee was quite pleased with portfolio returns in 2016. The S&P 500 was once again one of the best performing asset classes, which has the tendency to make asset allocation look foolish. But a closer look at returns shows we did indeed have a good year, with quite a bit less risk than just owning the S&P 500.

Our small cap and mid cap exposure is through the Russell index ETFs, so returns there were in line with corresponding benchmarks. Our large cap funds did quite well since we purchased the American Century fund at an opportunistic time. Our international stocks were fractionally positive while the EAFE index was up 1.0%.Our bonds were up roughly 3.5% while the Barclays Aggregate Bond index was only up 2.65% on the year. This was primarily due to our market neutral fund returning a healthy 5.6% on the year.

We will continue to employ a diversified approach through asset allocation to navigate this difficult landscape. This bull market, which began in April of 2009, is now nearly eight years old. They typically only last about 5-6 years. The last few years have been great for domestic returns and difficult for international stocks. Although on paper, this could continue in 2017 under the Trump administration, there is no guarantee that this will be the case. We will continue to keep our international exposure with the expectation that someday, it will offer us downside protection and enhanced returns.

FINANCIAL PLANNING

There are potentially many changes coming in 2017, but most are not effective. We thought we would highlight a few of the items that we know will indeed be in place right from the start.

- Elective deferral limits have stayed the same for 2017 at $18,000 for 401(k), 403(b), and 457s. The catch-up contribution is still $6,000 for those 50 and older.
- Income phase outs for Roth contributions have increased to $186,000 - $196,000 for married filing jointly and $118,000 - $133,000 for single taxpayers.
- Contribution limits for Traditional and Roth IRAs did not change. They remain at $5,500 plus a $1,000 catch-up for those over age 50.
- The income limit for social security taxes has increased to $127,500 from $118,500 which means that an additional $9,000 is subject to the 6.2% tax.
- The cost-of-living (COLA) increase for 2017 social security benefits increased by 0.3% and will be reflected in the January payments.

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.

- **Zillow**: This application is ideal for those looking to purchase or rent a home. The search filters are extensive and the format is very user friendly. The app will even use your existing location to help you look at homes when traveling in your car. The application is free on most platforms.
- **Tripadvisor**: This application connects you to millions of reviews, photos and maps from other users. Get instant reviews and photos for hotels, restaurants and activities. You can even book reservations for flights and hotels right through the application. It is a free application.
- **Netflix:** The Netflix application allows you to watch television shows and movies on your smart phone or tablet. There are no commercials and some content is only available on Netflix like Making a Murderer and Stranger Things. This is a must have if traveling with young ones. The application is free but Netflix does have a monthly fee of $9.

Company News

Lisa Vinson

Galecki Financial Management is pleased to announce our newest team member. Lisa Vinson joined our firm in December of 2016. She will be working at our front desk, greeting clients as they enter our office and answering telephones. Lisa has thirteen years of experience working in the financial industry so we will be utilizing her skills in other areas of financial planning as well.

When Lisa is not working she is an avid dog lover and enjoys the lake life. She also enjoys Indiana basketball, listening to Frank Sinatra, reading and writing poetry. Please welcome Lisa to the Galecki family the next time you are in our office.

- 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.