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Dear Client:

Each January we provide you with our annual letter to review the year just ended and preview the year ahead.

Because 2016 offers valuable investment lessons that can help you succeed in 2017, this letter will focus on the performance of the financial markets. As the year progresses, you'll receive additional information and advice from us to help you with the other aspects of your personal finances, including your taxes, insurance, mortgage, long-term care, college savings, employee benefits, Social Security and wills & trusts. We'll also share news with you about my new book, *The Truth About Your Future*, being published in March by Simon & Schuster.

The year just ended was indeed historic, and in many ways. It started off with a dreadful performance by the Dow Jones Industrial Average. You may have forgotten that the first week of 2016 was the worst opening week for the Dow in stock-market history; the index fell six percent in the first five days. And it continued to fall for five more weeks! By the middle of February, the Dow had lost 1,700 points and was down more than 10 percent. Do you remember how scared so many people were?

We do. We were getting panicked calls from folks who listen to my radio show who were frightened at the scope of the stock market's losses.

It took until early summer for stock prices to settle down – just in time for Brexit to take center stage. The unexpected decision by British voters to leave the European Union caused the Dow to immediately drop five percent – a loss of nearly 900 points in just two days. But within a week stock prices fully recovered and then some. Hardly anyone correctly predicted the Brexit vote, and virtually everyone thought that if the U.K. left the EU, stock prices would fall permanently. Both predictions were wrong. The lesson: Ignore those who make political predictions, and ignore those who make financial predictions. They are all unreliable.

This lesson was proven by our own election just five months after the Brexit vote. Few pundits predicted Donald Trump would win the presidency, and it seemed that everyone predicted a market crash if he did win. Both predictions were dead wrong. Trump won, and the stock market then rose to an all-time high.

So, we offer you hearty congratulations for tuning out the noise and sticking with your long-term strategy!

There is no question that Donald Trump's victory deserves some of the credit for the market's gains. We have elected a businessman to run the country, and it's reasonable to assume he will implement pro-business policies. This helps give investors a positive outlook for the future.

But the President-elect can't take all the credit for the stock market's recent gains. The fact is that the economy is doing very well, and recent data proves it:

- Home prices are now at their highest levels since 2006, according to the National Association of Realtors. Prices have gained five percent in each of the past two years. On an inflation-adjusted basis, prices are still below 2006 levels, suggesting that further gains are possible.
- Home builders spent more money on construction projects in 2016 than at any time in the past 10 years, according to the Commerce Department. This means home builders are expecting to sell lots of houses in 2017 – an important indicator for 2017.
- The nation's manufacturing sector expanded again in December – for the 91st month in a row, according to the Institute for Supply Management. Its index rose 14 percent over the prior year – a huge increase that suggests continued growth in this important economic sector.
- We sold more autos in 2016 than ever, according to data from the nation's automobile manufacturers – eclipsing the prior record set in 2015. Yet the average car on U.S. roads is 11.6 years old – an all-time high according to research firm IHS Automotive, which explains why expectations for auto sales are equally strong for 2017.
- The nation added another 156,000 jobs in December, says the Bureau of Labor Statistics. The unemployment rate is just 4.7 percent, as low as it was before the 2008 Credit Crisis began. We've added jobs 75 months in a row – the longest run since BLS began tracking data in 1939.
- Inflation remained low in 2016, at an annual rate of just 1.7 percent through November, according to BLS. This kept interest rates low, increasing the affordability of houses and cars for millions of Americans. (It also explains why the 2017 Social Security benefit increase is only 0.3 percent.)

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- For the first time since 2008, the average worker is beginning to enjoy a material increase in income: Wage growth in 2016 was 2.9 percent, according to BLS.

For all these reasons, consumer confidence is at its highest level in 13 years, according to the Conference Board. This means more consumers are willing to sign long-term loans so they can buy houses, cars and durable goods such as appliances and electronics. Being confident about your financial situation makes you more likely to take vacations, dine out, and buy clothes and jewelry. All that spending creates jobs, giving more people more income they can spend in the economy, which helps the economy grow even further – a virtuous (rather than vicious) cycle.

Strong economic data coupled with a market-friendly incoming president are the reasons the stock market has soared since early November. This is why we saw the Dow jump from 18,000 to 19,000, and from 19,000 to almost 20,000. So, looking ahead, will the Dow soon hit 21,000?

The lessons from 2016 tell us that…nobody knows. Yet many people are assuming the Dow will continue to advance unabated. We caution you not to be one of those people. It's easy to get euphoric after the stock market hits a new high, especially if you're pleased with the election's outcome. Optimism can cause people to take on more risk when prices are already high, distorting the carefully crafted asset allocation model we've created based on your long-term goals. This is not the time to increase your exposure to stock-market risk.

We have a parallel message for pessimists – both those who are upset about the election's results, and those who are worried about the Federal Reserve's recent increase in interest rates. Some people are wondering why they should continue to have bonds in their portfolios, because the Fed has promised more interest-rate increases, and rising rates means falling values for bonds.

There are two reasons you needn't worry about the bonds in your portfolio in the Edelman Managed Asset Program®. First, interest-rate increases are most harmful to long-term bonds, and you own little to none of them in your EMAP portfolio. (We removed them for you years ago, well ahead of the Fed's rate increase.) What remains in EMAP are short-term and intermediate-term bonds, and they are not nearly as susceptible to interest-rate risk as long-term bonds. Besides, if we were to completely eliminate bonds from your portfolio, you'd end up owning nothing but stocks – and that's a risky posture.

So, whether you're excited or worried about 2017, we encourage you to leave your EMAP allocation as-is – and if you're not yet withdrawing from your portfolio, continue to save and invest in accordance with the strategy you and your Edelman Financial Planner established. Your household wealth and reaching your goals are most likely determined primarily by how much and how often you contribute to your savings and investments, so if you haven't added money in a while, consider doing so now. And if the notion of "investing now" worries you, talk to your Edelman Financial planner *about dollar cost averaging*.

One final point about the stock market: Don't assume the Dow will go directly to 21,000. It could just as easily fall back to 19,000 first. I'll repeat a prior statement: The lessons from 2016 tell us that nobody knows what the future holds.

And even if (or when) the Dow reaches 21,000, our reaction will be a yawn. Here's why: in percentage terms, it's not a big deal.

Basic arithmetic explains why: When the Dow was 15,000, it had to grow 6.7 percent to reach 16,000. But when it was 18,000, it needed to grow only 5.6 percent to reach 19,000. And when today's Dow hits 21,000 that will represent a gain of only five percent. Indeed, each successive thousand-point milestone represents a smaller percentage increase.

So, let's not focus too much on these milestones – despite the fact that the media will.

We get more lessons from 2016 by examining the returns posted by the financial markets. Let's take a look:

- **The U.S. stock market did well, but returns weren't uniformly good.** Small companies grew twice as much as big ones; the Russell 2000 Index gained 21 percent, while the Russell 1000 Index gained only about half as much. And value stocks gained 21 percent while growth stocks gained a paltry three percent.

- **Bonds languished.** Treasuries overall gained only 0.8 percent, while the Barclays U.S. Aggregate Bond Index returned just 2.6 percent.
- **Real estate and gold produced competitive returns**, with the MSCI US REIT Index up eight percent and LMBA Gold up nine percent.
- **Returns from foreign stocks varied.** Latin American stocks climbed 32 percent, Asian stocks returned 13 percent and emerging markets returned 11 percent, while Europe ended with a gain of less than one percent. The MSCI EAFE Index, an overall measure of foreign stocks, returned just one percent.

The lesson learned: diversification and rebalancing are vitally important. With various asset classes producing such varied returns, the only way to be sure you'll capture the combined return offered by all these asset classes is to be invested in all of them. And rebalancing helps you take advantage of momentary fluctuations in the market. That's why we work so hard to provide you with a globally diversified portfolio and engage our daily strategic rebalancing review via EMAP.

Of course, past performance is no guarantee of future results, and market declines from time to time are certain to occur. And that's important to realize, because there is one more lesson to be learned from 2016: **never engage in market-timing.**

This final lesson is provided by 2016's performance of both oil and gold.

WTI Cushing Crude Oil jumped a whopping 45 percent in 2016 – and that might cause some people to want to invest in it now, incorrectly believing that last year's performance is certain to be repeated this year. Many of these folks don't know (or remember) that oil lost 30 percent the year before!

Gold offers another example of the lesson against market timing. All the performance data provided above assumes you owned the asset on January 1, and held all year. But instead of already owning gold on January 1, say you had bought gold in February in reaction to the stock market's decline in those first few weeks. You would have lost eight percent for the year. And if you had bought gold in late June in reaction to Brexit, you would have lost as much as 13 percent!

The takeaway is to buy your investments with a long-term focus, hold steady

with your investments in a diversified portfolio, and allow our daily rebalancing review help manage your risks over the long-term.

We begin 2017 with solid economic data, suggesting continued growth ahead. But we have a new president whose policies are unknown. And the world continues to face many threats. These are the reasons we encourage you to maintain a long-term perspective (one that will outlive any presidential term), maintain a globally diversified portfolio and engage in strategic rebalancing to help you achieve your financial goals.

As noted, this letter has focused on investments. You know we help you far more than that, so please call us if you have questions – not just about your portfolio but any aspect of your personal finances. After all, it's your goals that matter most – and our focus is to help you achieve them.

We wish you the very best for a healthy and happy New Year, and know that we're here to help.

Regards!

Ric Edelman
Founder and Executive Chairman

P.S. Feel free to forward this email to your family and friends. It may help them avoid making an expensive mistake in 2017!