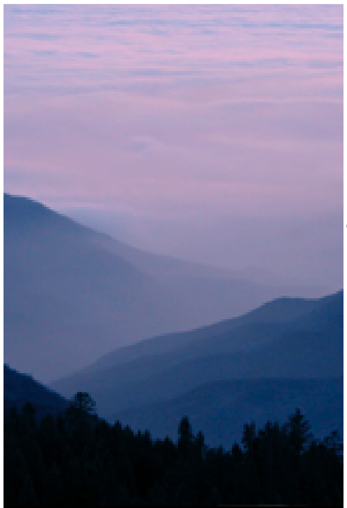

Quarterly Investment Report
September 30, 2016

Dear Investor:

The stock market in the third quarter came in like an innocent lamb and closed out like a rambunctious ram. July gently pushed higher, August was flat as a pancake, and September lived up to its reputation for being a difficult month - making sure investors remember that stocks are volatile assets. The S&P 500 rose 3.9% in the third quarter and is up 7.8% for the year on a total return basis (price and dividends). This year so far, Utility, Energy, Technology, and Telecom stocks have led the rise while Financial and Health Care stocks have detracted the most from investment returns.

RECIPE FOR MARKET VOLATILITY

A cup of POLICY UNCERTAINTY:

The U.S. presidential election features two unloved candidates. Investors fear Trump's inexperience, temperament, and intellect. They also fear Clinton's promise of increasing corporate regulations and higher taxes for the affluent. Policy uncertainty extends even further in Europe starting with the UK/Eurozone referendum (Brexit) in June, which promises to be a slow and tedious process. Additionally, Spain lacks a government thanks to deadlocked elections, Italy has an upcoming Senate reform referendum, and Germany and France have presidential elections in 2017. It's no wonder that, though European companies have comparably stable fundamentals, their stocks still trade at a 20% discount to U.S. stocks. The U.S. is still the safer and more reliable place to invest globally.

A heaping tablespoon of MONETARY POLICY DISTORTION:

Central bank balance sheets are still growing even after the massive post recession waves of bond buying. These purchases, called quantitative easing, not only serve to raise bond prices and lower bond interest rates to entice corporations and consumers to borrow for expansion and investment, but they put mountains of cash into the system. It's working a little, though much slower than desired. The Eurozone central bank signaled in the middle of September that they may soon be closing the spigots. Conversely, Japan followed later in September with a plan to hold interest rates low and even encouraged a higher inflation target. The U.S. Federal Reserve didn't make a move in September, signaling a "hawkish hold", meaning that it is increasingly likely we will see a rate hike of around .25% in short-term rates; probably in December. While such a small rate increase barely will affect lending decisions, the change in direction of rates is actually quite meaningful.

2 teaspoons of SLOW GLOBAL GDP GROWTH:

Global GDP growth is projected to slow marginally to 2.9% in 2016 from 3.1% in 2015. And GDP is expected to improve only slightly in 2017 to 3.2%. The volume of world trade growth is exceptionally weak and expected to fall below GDP growth for the year. This is all well below historical norms and highlights the global slow growth trap we've been in since the financial crises, and why global central banks have been loathe to end quantitative easing.

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A dollop of PROJECTED EARNINGS RECOVERY IN 2017:

Corporate earnings in 2016 have been pretty dismal, led by energy and other commodities. If earnings declined again for the third quarter as expected, that will be the sixth consecutive quarter of year over year negative earnings growth. But, the earnings for energy and other commodities are expected to bottom out in 2016, and 2017 is projected to be a year for earnings growth. The 2017 projected forward twelve month price to earnings (PE) ratio for the S&P 500 is 17 times. Though it is considerably higher than the 10-year average for forward twelve month earnings of 14 times, it isn't yet excessively high.

And a dash of AGING BULL MARKET:

There's no doubt that our current bull is an old chap. It's the second longest bull market ever, going strong since March 2009, and second in duration to the 1987-2000 bull market. Bull markets don't have to die from old age, they more typically stumble from excessive valuation.

These ingredients justify a volatile market and perhaps a few unsettling 3% to 5% corrections . But they don't scream "bear market on the immediate horizon". The fourth quarter is historically the strongest quarter in the year for markets (and even stronger in election years) but October is typically a rocky month. And, market weakness immediately after the election would not be surprising.

If anything, the economy appears to be getting stronger to support current stock valuations. Barring an awful event such as a terrible terrorist attack on U.S. soil, we expect the market to plod higher until valuations get seriously overheated. The housing industry, which accounts for 15%-20% of overall GDP, is strong. Supply is tight with months of supply for both existing and new homes at multi-year lows. And pent up demand is huge. Another positive for the economy is that commodity prices are turning the corner led by a floor price of $40 for oil.

We think we have yet to see higher highs in stocks before the next bear market. As we approach our valuation limits, we will increase portfolio cash allocations to mitigate some portion of expected stock market declines. With that said, remaining mostly fully invested in long-term asset allocations is an important pillar of our investment philosophy. It is impossible to predict the market, and our investment discipline of owning strong companies that can best perform during down cycles, has proven to be the most effective long-term investment strategy.

Sincerely,

Ellen P. Le, CFA
President

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Clinton And Trump Tax Proposals Until They Change…

The two candidates have very different tax policy agendas. Donald Trump wants to cut taxes across the board while Hillary Clinton wants to raise rates and limit some write-offs for wealthy taxpayers.

Trump would condense and lower the current six individual federal income tax brackets to three: 12%, 25%, and 33%; the current top bracket is 39.6%. He has also proposed to eliminate alternative minimum, estate and gift taxes, and lower investment income and business income taxes. Trump hasn't spelled out how he would pay for the tax cuts.

Clinton would cap itemized deductions (could encourage faster mortgage pay downs) and introduce a surtax on annual income above $5 million. That would raise the top marginal rate to 43.6% which is expected to affect only about 2 out of 10,000 taxpayers. Additionally, those earning more than $1 million annually would be subject to the Buffett rule, which is a minimum effective tax of 30%. Clinton also proposes restoring the 45% rate on estates over $3.5 million, affecting about four out of every 1,000 individuals.

Realistically, none of these proposals stand much of chance of passing. Even if Clinton wins the election and the Democrats win the Senate, polls suggest that the House of Representatives will stay firmly in Republican hands. The odds of any significant tax reform seems low.

It's now a little over a month until this very very very long presidential campaign is over. Though investments will likely face intense volatility until then, no matter who wins the election our markets will adapt as it normally does, and focus on a reflection of underlying corporate value.

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A few IRA Reminders before Year-End

If you're already retired, perhaps already taking Required Minimum Distributions from your IRA, and not concerned with contributing to an IRA…pass this information onto your kids and grandkids…remember that the best time to invest is… 20 or 30 years ago!

Taxes

- All IRA's are tax-deferred accounts…that means you don't pay any taxes on dividends, interest, and capital gains earned each year. For example, assuming a 5% average annual return and a 20% tax rate on earnings, $5,500 put away each year for 35 years would grow to about $496,000 in an IRA account and about $426,000 in a taxable account. That's a sizable $70,000 difference thanks to tax deferment. Traditional IRAs are taxed at ordinary tax rates when money is withdrawn and a portion of the money must be withdrawn each year once you reach age 70.5 based on IRS annuity tables of life expectancy.
- The Roth IRA is the only IRA account where you also don't pay any taxes on the money that you withdraw from the Roth IRA. That's because Roth contributions are made with after-tax money.
- If you participate in a retirement plan at work, contributions to a traditional IRA are deductible if you earn less than a certain level of income. For married couples, if both you and your spouse don't participate in a retirement plan at work, your IRA contributions are deductible no matter what your income is.
- Keep track of after-tax non-deductible contributions made over the years on IRS Form 8606 so that you won't pay taxes on the after tax contribution amounts when they are withdrawn (these after-tax contribution amounts are apportioned throughout your lifetime of withdrawals).

Contributions

- You can contribute to a traditional or Roth IRA up to $5,500 if you are under 50 years old and $6,500 if you are 50 or older. You can't contribute more than you earn, so if you earned $4,000 for the year you can only contribute $4,000.
- In the year you turn 70.5 you can no longer contribute to a traditional IRA but you can continue to contribute to a Roth after age 70.5 as long as you don't contribute more than you earn.
- There are salary limitations for contributing to a Roth. Single people can't contribute if they earn more than $132,000 and married couples can't contribute if they earn more than $194,000.
- You can contribute to either a traditional IRA or Roth (but not both) even if you contribute to a retirement plan at work.

Withdrawal Rules

- If you withdraw money from your IRA before age 59.5 you will get hit with a 10% penalty on the withdrawal amount. There are waivers from this penalty, though, if the funds are used to buy a first home, educational expenses, disability, unreimbursed medical expenses, and taking periodic payments.
- If you don't take your traditional IRA Required Minimum Distributions at age 70.5 you will be hit with a 50% penalty on the amount that should have been withdrawn.
- You don't have to withdraw from your Roth IRA during your lifetime.

Deadlines

- You can contribute for 2016 to your traditional or Roth IRA up until April 15th of 2017.

TIPS FOR YOUNGER INVESTORS:

- If you can qualify, invest in a Roth IRA sooner rather than later!
- If you earn too much to qualify for a Roth, you may still move small amounts from your traditional IRA to a Roth IRA each year; you will be taxed on those transfers, so discuss first with a financial or tax advisor.