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Dear Clients and Friends,

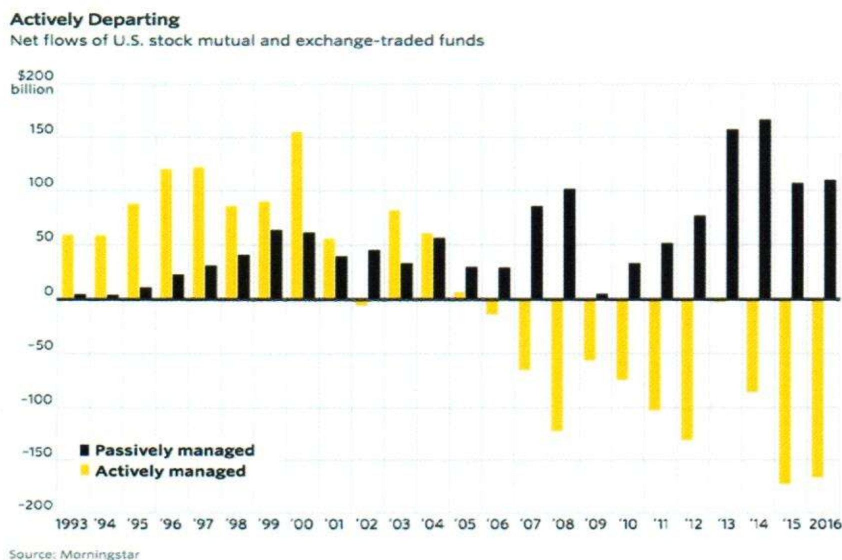
"Only liars manage to always be out during bad times and in during good times."
— *Bernard Baruch*

The year 2016 was certainly a memorable year and one in which our country and maybe the entire world seemed to become increasingly divided. It feels as if fewer people are willing to look for the middle ground and most have firmly picked one side or the other to dig in with their views. Of course, we could be discussing this in regard to politics, race relations or religion, however, we could just as easily be discussing investor sentiment.

Nearly all investors today are either in the "Active" camp or the "Passive" camp. We wrote to you about this very subject back in July 2015 where we defined these terms:

"Active investing, meaning placing investment funds in the hands of a manager who actively invests and manages capital in their area of expertise, while passive investing means putting funds into an index or benchmark such as the S&P 500 (for instance, a Vanguard S&P 500 index fund). The mission of the active investor is to outperform their benchmark, while the passive investor strives to duplicate the return of the benchmark." Active investing typically comes with a higher cost as the investor is paying for the investment expertise of a professional manager making individual security transactions, while passive investing typically levies a much lower fee to simply purchase and hold a broad basket of securities.

Much like being a Democrat or Republican, there is little common ground and agreement between these two investment philosophies. However, if this was a prize fight, it would be called right now in favor of passive investors because billions of dollars have been flowing out of active strategies and moving to passive investments as indicated by the graph below:



As you can see, passive strategies have generally gained ground on active ones since around the time of the 2008 financial crisis. We do not think this is a coincidence. Since that time, hundreds of new financial products have been created that are designed to provide investors with easy access to invest in broad market indexes. The exchange traded funds (ETF's) referenced are baskets of stocks that trade like a stock throughout the day, while mutual funds can only be traded once at the end of the day.

As a general rule, all investors should benefit from financial products that provide liquidity and access to the broad markets. The problem is not with the financial products that are available (although some are poorly structured and not very liquid). The problem is ourselves. We spoke to you at length about this topic back in April ("We have met the enemy and he is us.").

The proliferation of new products and money flows into passive investment strategies has given investors and financial advisors the ability to jump in and out of markets with a click of the mouse. What used to take days to unwind now takes seconds.

As BILLIONS of dollars have moved into these strategies, markets now move quickly over short periods of time as sentiment changes. We have witnessed these recent spurts of high volatility that are sudden and severe. However, over the long term, markets tend to sift through and process information and then stabilize based upon fact and data versus emotion.

Now, armed with financial products that are bloated with billions of dollars that can be bought and sold in a nanosecond, investors can quickly move in and out markets every day. This freedom is theoretically great, but the results are less than stellar. A well-known market research firm, Dalbar, recently published a report titled, *Quantitative Analysis of Investor Behavior* where they illustrated that the average equity fund return that investors received from 1984 – 2014 was approximately 3.66%. During this same time period, the S&P 500 returned 10.35%.

Why such a difference in returns? Perhaps when investors are left to their own devices (or not protected by their advisors), they tend to sell during falling markets and buy in rising markets. Attempting to time the market, whether a professional or amateur investor, is a losing strategy over long periods of time. We are now inundated with financial products that make this strategy readily available and seemingly easy to execute.

Turning our attention back again to 2016, the S&P 500 returned 11.96% despite many ups and downs during the year. Given the above Dalbar research, it is fair to assume that most investors did not receive returns anywhere near that level regardless of their investment style. Take a look at the following data, showing how the S&P 500 performed from various high and low points throughout the year:

Time Period	Days	S&P 500 Return
1/1/2016 – 2/11/2016:	42	(10.27%)
2/11/2016 – 6/9/2016:	119	15.10%
6/9/2016 – 11/4/2016:	147	(0.80%)
11/4/2016 – 12/31/2016:	57	7.60%
1/1/2016 – 12/31/2016	**365**	**11.96%**

How many investors (or their advisors) panicked in February when they were down over 10% and got out of the market? How many then missed the next 4 months producing 15% positive returns? How many panicked again after the elections and missed the next 7.60% up. Let's also not forget about the costs of taxes and commissions for these transactions. How many simply were confident in their long term strategies and sat patiently for the entire year?

We are very happy to say that the vast majority of our clients did the latter and benefitted accordingly.

In many ways, 2016 was a typical year in regard to market performance. The end results were excellent, but there were numerous high and low points in between along with a myriad of events that garnered big headlines. Moments of fear were followed by euphoria and then fear again.

Despite all of the products created to allow investors rapid access to and from the markets, executing a successful strategy of timing the market remains nearly impossible over the long term. We remain steadfast in our conviction that a focus on patience and long term results will allow us to compound capital for clients at very attractive rates of return. There is an old saying that very much still rings true today: "It is time in the market, not timing the market."

Finally, a brief reminder that we are moving towards the electronic delivery of these reports and we intend to discontinue these mailings in the future. As we have mentioned, we will be introducing you to your new client portals over the coming weeks. These portals will provide you with secure 24/7 access to these reports along with your Fidelity monthly brokerage statements and trade confirmations. If you would like to continue receiving these reports via the mail, please contact Sonja Elia at (904) 674-3353 and let her know.

As always, we thank you for your continued support and wish for a happy, healthy and prosperous new year for us all.

Best regards,

Bob

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