REFLECTIONS

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To Your Future Prosperity

AVERAGE RETURNS AREN'T NORMAL, NORMAL RETURNS ARE EXTREME

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An average return is in fact exceedingly rare

You have many ways to achieve your financial goals: your choices, spending habits, how much you save, how much you earn, and of course your investment returns. If your ability to save and invest is the gasoline that powers you along your financial road map, your portfolio returns are the engine that get you there. With smart choices and hard work, you'll be coasting into retirement and once you're there, you'll be feeling good about your patient and disciplined investment program. The issue? Investment returns are impossible to guarantee and in the short-term, just as hard to predict.

Most investors are familiar with the idea of planning around a long-term average return. We might typically estimate an average stock return of 8-10% per year (in fact, the S&P 500 Index has returned an annual average of 10.1% since 1926)*. But will you actually earn 10% in a single year? Almost never. Instead, actual returns fluctuate significantly above and below the long-term average. This roller coaster of highs and lows is what investors really feel, perhaps yourself included as you reviewed your year-end statements.

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The table below shows how the S&P 500 Index returns have been distributed since 1926. Over 90 years provided, there have been only six years when the annual return was within even 1% of the long-term average! This means that if you expect your portfolio to return 8, or 10, or 12% per year, more times than not, you will be far off in your estimate.

The average return is in fact exceedingly rare. Planning with a long-term average in mind works because if you set your time horizon and stay committed to the long-term, the averages can be achieved. But no portfolio grows steadily each and every year at a target percentage because the markets are far more volatile than simple averages suggest.

> "Stocks up significantly 37% of the time."

7% OF YEARS	7% OF YEARS	13% OF YEARS	16% OF YEARS	21% OF YEARS	37% OF YEARS
1930	1940	1929	1947	1926	1927
1931	1941	1932	1948	1944	1928
1937	1957	1934	1956	1949	1933
1974	1966	1939	1960	1952	1935
2002	1973	1946	1970	1959	1936
2008	2001	1953	1978	1964	1938
		1962	1984	1965	1942
		1969	1987	1968	1943
		1977	1992	1971	1945
		1981	1994	1972	1950
		1990	2005	1979	1951
		2000	2007	1986	1954
			2011	1988	1955
			2015	1993	1958
				2004	1961
				2006	1963
				2010	1967
				2012	1975
				2014	1976
					1980
					1982
					1983
					1985
					1989
					1991
					1995
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					1997
					1998
					1999
					2003
					2009
					2013
<-20%	-20% to-10%	-10% to 0%	0% to 10%	10% to 20%	>20%

*Source: Ibbotson Classic Yearbook, 12/31/1925 to 12/31/2015.

AVERAGE RETURNS AREN'T NORMAL, NORMAL RETURNS ARE EXTREME (CONTINUED)

Some other interesting historical points that can be read from the table:

- Markets are good much more often than bad. Stocks were positive 73% of the time, in 66 out of 90 years.
- Big years are frequent. Stocks are up significantly (>20%) in 33 of 90 years, or 37% of the time.
- Painful years bring strong recoveries. The four most recent years when the market was down 20% were each followed by a year up 20% or more (1937/38. 1974/75, 2002/03, 2008/09).
- Positive years often beget more good news. In 15 years when the market was up 20% or more, the following year was up another 10 or 20% or more.

The benefits of long-term investing are clear: good returns outweigh bad, strong years are frequent, and with the right commitment and planning, your target return averages can be achieved. But you'll need to set your expectations for a market roller coaster that moves much more than the average might suggest in a given year. Do that and your portfolio engine will stay well-tuned for success.

> "Over 90 years provided, there have been only six years when the annual return was within even 1% of the long-term average!"

HOW WORKING IN RETIREMENT AFFECTS SOCIAL SECURITY

For many retirees, retirement doesn't mean stop working. Retirement can be the time to pursue a second career or a business idea you've always dreamed of. After all, it can be much easier to stay happy and healthy when actively engaged in meaningful, fun work.

If you choose to work in retirement, what impact does this have on your Social Security benefit? And what do you need to know today to make the most of your retirement income tomorrow?

There are two main points to know. First, working will reduce your benefit if you begin taking Social Security before your full retirement age. And second, there's good news. If you earn more in your later years, it's possible that continuing to work will increase your Social Security benefit. Also, if you take a part-time job or work at a lower salary, there will be no reduction in your benefit.

A Social Security Benefit Review

Your Social Security benefit is based on your highest 35 years of earnings, up to a maximum annual earnings level ($118,500 in 2015).

To calculate your benefit, the Social Security Administration records your earnings history since the age of 16 and indexes these earnings up to today's dollars, based on historic wage growth. Earnings after age 60 are treated at face value. The top 35 highest earning years (once indexed) are then averaged to find your "average indexed monthly earnings." It is this number which is used to calculate your benefit. You'll receive 90% of the first $826, 32% of the next $4,154, and 15% of anything remaining. The sum is your Primary Insurance Amount (PIA), which you will receive at full retirement age. You can see your estimated benefits and earnings record online at www.socialsecurity.gov/myaccount/.

"Working will reduce your benefit if you begin taking Social Security before your full retirement age."

Work + Claim Early = Reduced Benefits

Your benefit will be greatly reduced by working if you're drawing social security before your full retirement age. For those under full retirement age for the entire year, Social Security deducts $1 for every $2 you earn above $15,720 in 2016. The year you reach retirement age, this drops to $1 for every $3 you earn above $41,880, but earnings are only counted in the months before you reach your full retirement age. The benefits are not lost forever though. Once you reach full retirement age, your benefit will be adjusted to include the amounts that were previously withheld with an inflation adjustment.

Earnings counted toward the $15,720 threshold are a bit different than your taxable income. They count wages from a job and self-employment income, but pensions, annuities, investment income, interest, and government, veteran, or military benefits aren't included.

Remember that if you file early, your benefit is already greatly reduced – for the rest of your life. Adding a reduction for income will reduce your benefit even further. So if you're thinking of working and filing for Social Security early, see if you can make it on your earnings and savings alone.

If working and you've already filed for Social Security, there's a chance you can change your mind. If you're within 12 months of the time you filed the paperwork, you can reverse your decision – as long as you pay back the money.

"If you're thinking of working and filing for Social Security early, see if you can make it on your earnings and savings alone."

How Working Can Increase Your Benefit

If you can wait to take your benefit past age 65, it's possible that working will increase your benefit. After all, Social Security takes into account your 35 highest earning years. So if this year's earnings are replacing a lower-earning year when you were flipping burgers, your benefit will re-calculate and increase. If you already have 35 high-earning years credited, the extra work will likely have no impact on your benefit (although it could affect how your Social Security benefits are taxed). You can use Social Security's online retirement estimator to project your retirement benefits.

This scenario won't only increase your own benefit – it can increase your spouse's benefit too. Both spousal and survivor benefits are based upon your PIA, which again will be determined by your highest 35 years of earnings history.

It is unlikely that any benefit increase will be large enough to keep a weary near-retiree working longer. In the end, the wages from the earnings themselves will far outweigh any benefit received from Social Security. And if working keeps you from tapping into your retirement nest egg, even better. But if you want to work in retirement, know you might be rewarded with a higher Social Security benefit at the same time.

There are many reasons to work in retirement. But as you work, make sure to understand exactly how your benefit will change due to your working income. There's a significant amount of money to gain – or lose – when taking your Social Security benefit.

"If this year's earnings are replacing a lower-earning year when you were flipping burgers, your benefit will re-calculate and increase."

Windgate does not provide tax advice. Consult your professional tax advisor for questions concerning your personal tax or financial situation. Data here is obtained from what are considered reliable sources; however, its accuracy, completeness, or reliability cannot be guaranteed.

ALL WEATHER PORTFOLIO REVIEW

The All Weather approach is designed to provide you with exposure to the financial markets while mitigating downside risk. We made several changes in 2015 to your portfolios based on our analysis of market signals and investment valuations.

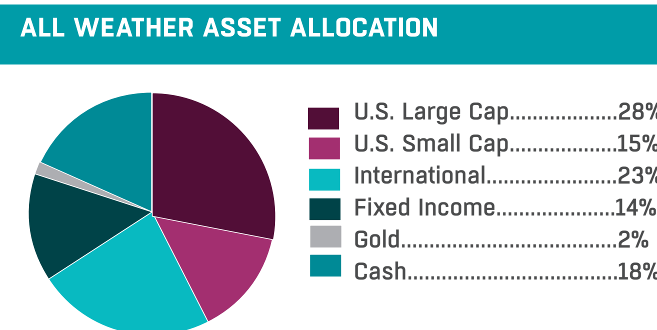
Early in the year, we reduced our allocation to the S&P 500 Index from approximately 20% to 15%. This decision was made in order to take advantage of different opportunities in sectors of the market we found to be comparatively undervalued. If you recall, U.S. large-cap stocks were among the top performing asset classes in 2014, leading us to take profits to invest in areas with greater upside. While we reduced holdings to core U.S. large-cap stocks, we still maintain a sizable allocation to this sector, which includes not only our investment in the S&P 500 Index but an additional focus on dividend-paying and value companies. Overall, we continue to be positive on the long-term prospects for U.S. stocks as the economy continues to move along, albeit slowly.

We worked throughout the year at finding attractive values overseas, leading to an investment in the WisdomTree Europe SmallCap Dividend ETF. While we have held large-cap European stocks for many years, this was a new exposure to small-cap European stocks. Just as we saw in the US, European small-cap stocks have been trading at much lower valuations relative to European large-caps, which we believe from experience spells opportunity. We opted for a dividend-focused investment to add income to the portfolio. In addition, companies that pay sustainable dividends tend to be mature and conservative investments and unlike the more speculative growth companies you find in a standard small-cap index. This makes our small-cap overseas investment a more conservative choice which we believe hedges against downside risk.

"We worked throughout the year at finding attractive values overseas, leading to an investment in the Wisdom-Tree Europe SmallCap Dividend ETF."

The risks in the high yield fixed income market led us to sell our High Yield bond exposure completely last year. Despite being one of the few places investors can find yield (or high interest rates), the risk of energy companies defaulting on their debt became too great. Many high yield bonds are issued by oil and gas producers who find themselves struggling mightily with the collapse in the price of oil. This led to a great increase in the interest rate spread between high yield fixed income and investment grade fixed income, meaning that investors began selling high yield bonds quickly and liberally. Increases in credit spreads occur when lenders require higher interest rates from lower credit quality borrowers due to diminished expectations for the business/economic prospects. When this occurs for the fixed income space as a whole, this can be considered a signal that it's time to exit high-yield fixed income positions. We will look to purchase a replacement this year that is a more diversified and conservative bond portfolio to supplement some income for the portfolio.

We also took an opportunity to make an investment in our own Perritt Low Priced Stock strategy. The portfolio recently attained a three-year track record, which was in the top 2% of all funds. This portfolio is a traditional small-cap strategy, meaning we are uncovering companies with a larger market-cap than in our micro-cap portfolios. We made the decision to add an investment in traditional small-caps because the performance gap between large- and small-cap companies is reaching its largest spread since the start of the financial crisis in 2008. When one sector of the market underperforms another to the extent that we saw in small-caps vs. large-caps, there is a strong historical tendency for a "mean reversion," meaning the underperforming asset will reverse trend and outperform in the future. As always, we will look at each investment opportunity based on its valuation metrics and from the perspective of a long-term investor.



GLOBAL GROWTH PORTFOLIO REVIEW

The Global Growth strategy is a diversified portfolio focused on high growth and international opportunities. International and emerging markets continue to look considerably less expensive than domestic equities, following a year when U.S. equities saw modest gains and many emerging markets saw steep losses. With this relative value in mind, we continue to rotate your portfolios further toward an international stance. Increasing the exposure to these less expensive markets raises our forward expected return.

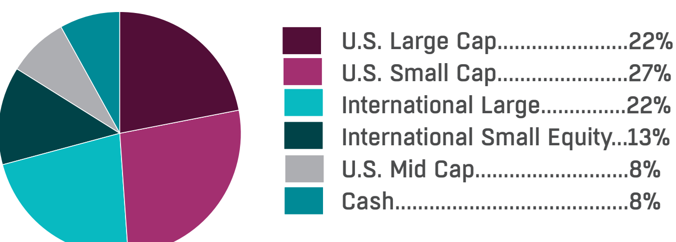
After witnessing the abrupt move of the Swiss National Bank in January 2015 to remove the Swiss franc currency that the Bank supported vis-à-vis the Euro dollar, we correctly anticipated that the European Central Bank (ECB) would imminently pursue quantitative easing (QE) in Europe and made our first strategic rotation trade from domestic to international. To position for the expected positive effect, we believed this would have on European equities, we cut back exposure to U.S. large-cap and U.S. mid-cap in favor of a new allocation to core Europe via the iShares Europe (IEV) ETF. Though the progress in Europe has been slow thus far, we continue to believe that the ECB policies will continue to aid Eurozone economies and positively influence asset values.

Beyond the long-term strategic positioning of the portfolio, we also took advantage of shorter term tactical opportunities. Over the past year, markets across all asset classes have become increasingly volatile. This volatility allows nimble investors the opportunity to make tactical trades. In January 2015, we saw an opportunity to make a tactical investment in oil-related stocks, which had been devastated in the preceding six months and had become oversold. We invested in energy services companies with oil trading at roughly $44/barrel. Four months later, with oil having rebounded to $60/barrel, we concluded the “bounce” in oil had run its course and sold out of our positions in energy stocks for a double digit gain. We were pleased with the results of our tactical trades and found these types of opportunities complement our long-term approach with the core of the portfolio.

“With this relative value in mind, we continue to rotate your portfolios further toward an international stance.”

Back in the US, we made a sector based allocation in purchasing the Hennessey Small Cap Financial Fund (HISFX). This "theme based" decision was driven by our anticipation of what we believed to be an upcoming raise in interest rates by the Federal Reserve. This historic raise was delivered by the Fed in December, and after receiving this confirmation, we subsequently increased our position. Our view is that bank profitability and hence bank stock prices will benefit from higher US interest rates.

GLOBAL GROWTH ASSET ALLOCATION

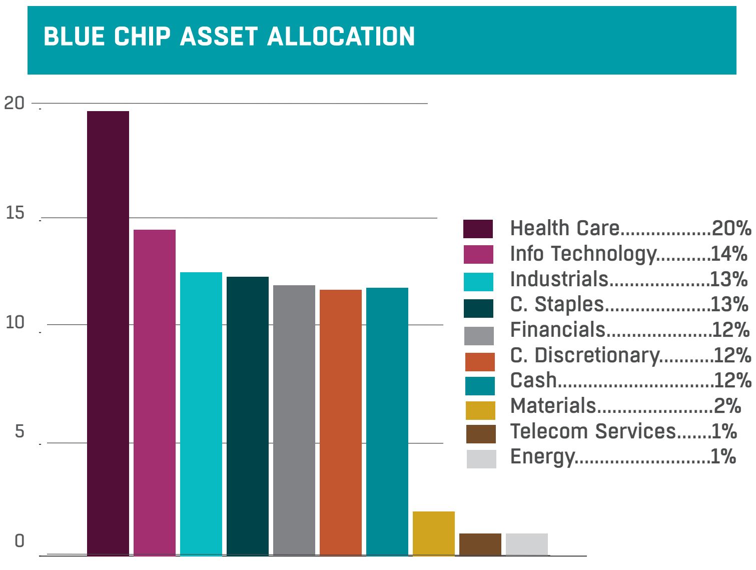


Lastly, to close the year, we again strategically increased our international exposure through the purchase of the Pear Tree Foreign Value Small Cap Fund (QUSIX). Pear Tree was founded and is run by Bernard Horn, a manager with a highly successful track record as an international value investor. Pear Tree is solely focused on international markets as a firm. After meeting with a member of the Pear Tree team, and conducting due diligence on the fund, we became increasingly pleased with their focus, value discipline, and track record.

We continue to be excited by the opportunities presented by global markets. We believe the shifts we have made to take advantage of these opportunities may ultimately be profitable for our clients. We will implement changes to portfolios – strategic, thematic, or tactical – when we believe it is in your best interest. Our goal is to continue to rotate the Global Growth Portfolio towards markets that offer relatively more attractive valuations, and represent a better reward for risk.

BLUE CHIP PORTFOLIO REVIEW

At a glance, the last year in the Blue Chip market appears uneventful. At the end of 2014, the S&P 500 Index was at 2,058.90. One year later we sit at 2,043.94. That is a negative return of less than 1%, and with dividends included, the return was +1.38%. Yet by looking at start-point to end-point, the investor would have no idea of the volatility that played out during the year. The S&P 500 Index, factoring in dividends, started the year out by declining 3.00% in January then rallying 5.75% in February. The Index then traded basically sideways during the March-July period. Volatility picked back up in August as the Index dropped 6.03% then declined an additional 2.47% in September before jumping 8.44% in October. The rest of the year was relatively tame in comparison with only a decline of 1.58% in December.



There were a few primary factors that impacted stocks during 2015; we saw a further decline in commodity prices, particularly oil; we saw a continued strengthening of the dollar; and China devalued the yuan which led to the correction in the August-September timeframe. Additionally, we saw the Federal Reserve raise interest rates at the end of the year. On top of these factors, you had the market driven by only a few select stocks, the so-called ***FANG*** stocks: *Facebook (**F**B), Amazon (**A**MZN), Netflix (**N**FLX), Alphabet (**G**OOGL).* Both Amazon and Netflix stock prices doubled during the past year. Facebook and Alphabet stock prices each appreciated by more than 30% during 2015. Without these stocks leading the way, the return for the S&P 500 Index during 2015 would have been much less.

The Blue Chip portfolio is designed to meet or exceed the return of the S&P 500 Index on a risk-adjusted basis. Individual returns may differ as a result of a number of factors such as desired cash levels, individual positions, and position sizes. Protecting capital is the main goal, however we also strive to generate returns for our investors. We continue to look to invest in companies that generate strong cash flows, have high return on equity, and maintain a solid balance sheet.

During 2015, Consumer Discretionary was a strong sector in the market. We benefited along with this sector due to our allocation in The Home Depot Inc. (HD) which was the top performing stock in the portfolio during 2015, up more than 25%. Healthcare and Consumer Staples were also solid performing sectors, and within these sectors two of our better investments were CR Bard Inc. (BCR) and The Kroger Co. (KR). Both stocks were up over 10% for the year. Energy was a dangerous sector in 2015, as the sector as a whole, as measured by the Energy Select Sector SPDR Fund ETF (XLE), declined more than 20%. Our limited exposure to the energy sector was also a benefit to performance during the past year. We held a larger cash balance during 2015 than normal, as we were concerned with some Blue Chip companies seeming overvalued. We continue to hold this cash and will seek to deploy the cash during the year, as we uncover stocks that appear attractive based on our disciplined approach.

> "We continue to look to invest in companies that generate strong cash flows, have high return on equity, and maintain a solid balance sheet."

2015 MARKET RETURNS

Foreign Markets	
U.K. (FTSE 100)	-1.32%
Germany (DAX 30)	9.56
France (CAC 40)	8.53
Canada (MSCI)	-25.84
Japan (NIKKEI 225)	9.07
Hong Kong (Hang Seng)	-7.16
India (Sensex)	-5.03
Russia (MSCI)	-0.05
China (Shanghai)	9.41
Mexico (iPC)	-0.39
Brazil (Ibovespa)	-13.31
Argentina (Merval)	36.09

U.S. Stocks	
Dow Industrials	-2.23%
Nasdaq Composite	5.73
S&P 500	1.38
Russell 2000	-4.41
Wilshire 5000	-1.45

U.S. Industry Performance	
Basic Materials	-8.69%
Consumer Discretionary	9.90
Consumer Staples	6.87
Financials	-1.77
Health Care	6.83
Industrials	-4.32
Energy	-21.50
Technology	5.47
Telecomm	0.21
Utilities	-4.93

USD vs	
Euro	11.45%
British Pound	5.68
Canadian Dollar	19.81
Yen	0.33

Bond Yields (Change)	bps	Ending Yield
30-yr T-bond	0.26	3.01%
10-yr T-bond	0.10	2.27
3-month T-bill	0.12	0.16

IRA CONTRIBUTIONS DEADLINE

Don't forget, 2015 contributions for IRAs and Roth IRAs must be made by April 15th. Maximum contributions are $5,500 per individual ($6,500 if you are age 50 or over). Income limits for contributing to Roth IRAs or making deductible contributions to Traditional IRAs are below. You can also still benefit from tax-deferred growth in a traditional IRA by making non-deductible contributions should your income exceed the limits. Remember, contributions can be made from both cash on hand or from your taxable investment

IRA 2015 INCOME LIMITS

Filing Status	Roth IRA Can contribute if your Modified AGI is	Traditional IRA Can deduct contributions* if your Modified AGI is
Single or Head of Household	<$131,000	<$71,000
Married Filing Jointly	<$193,000	<$118,000
Spousal IRA (Those with spouse who earns no income)	N/A	<$193,000

**If you are not covered by an employer plan, you can deduct 100% of IRA contributions regardless of income.*

Source: IRS.com.

Any opinions expressed in this article are general in nature and cannot be guaranteed to be suitable for every individual. Individual needs and situations vary. Talk to your financial advisor to help you consider what options might be right for you.

The information provided herein represents the opinion of Windgate Wealth Management and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice. The information is neither a recommendation to buy or sell a security or invest in a specific sector.

Perritt Capital Management, Inc. is the registered investment advisor for Windgate Wealth Management accounts.

CELEBRATING 25 YEARS

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