WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

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Review & Outlook – As 2016 fades from the rear-view mirror there is a renewed sense of optimism about the U.S. economy and the prospects for tax & regulatory reforms, job gains, and business profitability. President-elect Trump and the Republican sweep of Congress has set the stage for major fiscal initiatives to reinvigorate America. The stock market started 2016 with a brutal decline, then slowly rebounded only to be pounded again after the surprise Brexit vote. Many investors were nervous about the market reaction to a possible Trump victory, and as often happens the consensus was fooled again by a strong post-election rally. With the Dow knocking on the door of 20,000, how much gas is left in the tank? We are approaching the eighth anniversary of the current bull market and valuations are stretched, but earnings growth is the primary driver of stock prices, and many companies continue to prosper. As always, we will be monitoring the upcoming quarterly earnings reports and economic numbers for any trend changes. Last year, interest-sensitive utilities, telecoms, and REIT's were star performers. Once interest rates turned higher, we reduced our exposure in those areas but have maintained positions in industrials, materials, financials, energy, and consumer discretionary stocks.

Early last quarter we reduced our exposure to investment grade bonds and raised cash thus avoiding much of the carnage inflicted upon that area as interest rates ticked higher. Long-term high quality bonds are the most vulnerable to interest rate risk, so we own primarily shorter-term bonds and are willing to forgo some current yield in exchange for greater safety.

Our strategy continues to focus on constructing balanced all-weather portfolios of individual securities, ETF's, and actively managed funds. We want to own best of breed, keep investing costs low, and provide competitive returns while protecting against large losses. Our goal is to provide tax-efficient wealth management solutions and peace of mind to our clients.

Fixed-Income: Bonds / Funds & ETF's – Never forget that interest rates and the prices of existing bonds move in opposite directions. The fixed interest payments are worth less when market interest rates move up. Following the 10-year U.S. Treasury yield is a good barometer. That yield bottomed out at 1.34% in early July, rose to 2.63% in mid-December and ended the year at 2.43%. Even though the Federal Reserve had indicated they intend to increase short-term rates three time in 2017 by 0.50% each time, that does not necessarily translate into higher long term rates. Long rates are driven more by economic growth, inflation expectations, and competing global yields when foreign capital is seeking a safe haven. We continue to hold a wide variety of individual tax-exempt municipal bonds and expect to hold them to maturity. It gets trickier with bond funds which have no set maturity date and can suffer debilitating principal erosion in a rising rate environment. For IRA's and other retirement plan accounts our fixed-income exposure is split between short-term and high yield funds. We hold the **Vanguard Short-Term Corporate Bond ETF**, the **PIMCO Short Term Institutional**, and **U.S. Treasury Notes** maturing in 1 -3 years as lower risk cash alternatives.

For higher yields, we own and continue to like the **T. Rowe Price Institutional Floating Rate**, 4.3% yield, **PIMCO Income Fund**, 5.5% yield, and **Vanguard High Yield Corporate**, 5.5% yield. They provide specialized managerial expertise with low share price volatility. A couple of hard hit areas in the post-election fallout were emerging market and municipal bonds. Both areas are oversold and represent good value, so we recently established new positions. The **Fidelity Advisor Emerging Markets Income**, 5.5% yield, is a safer way to play the growth of emerging markets versus stocks. Lower potential income tax brackets under the Trump administration sent muni bonds into a tailspin, but prices have stabilized so we repurchased the granddaddy of CA muni funds, the **Franklin CA Tax-Free Income** at a lower price point, 3.7% tax-free yield. All of these bond funds pay monthly dividends which are automatically reinvested to compound returns.

Common Stocks – We own industry leaders that differentiate themselves from the competition with a unique product, service, or value proposition. We are not averse to turnaround situations, but prefer a strong balance sheet with low debt along with revenue and earnings growth. Quarterly cash dividends are icing on the cake. Our bets are spread across different industries to diversify sector specific risk.

Walt Disney had a number of insider buys in December and has made an impressive turnaround with the opening of Shanghai Disneyland, movie hits Moana and Star Wars Rogue One, and partial ownership of Hulu, a lower-cost streaming alternative to cable TV. **Costco Wholesale** is a value shopper's mecca that is surviving the brick & mortar onslaught from **Amazon.com**. They are our two favorite retailers. **Starbucks** has been treading water, but is ramping up their overseas operations for another growth spurt.

Visa dipped last quarter as the CEO retired, but their electronic payments network is unrivaled and company remains one of our largest positions. They just announced a partnership with Honda for in-car purchasing at smart parking meters and fuel pumps using Visa Token Service, a secure platform for mobile transactions. **Charles Schwab Corp**. was a big winner last year as financial stocks rallied on the prospect for higher interest rates. Higher rates allow financial firms to increase their net interest margins. Schwab's institutional business is growing as more financial advisors opt to leave the commission broker world and become independent advisors. We were pioneers and have been partners with Schwab since 1991.

Healthcare was the worst performing sector last year, so we've picked up a couple of bargains. **Pfizer** has been held back by the pending 2017 patent expiration on Viagra, but they have many other irons in the fire with potential blockbusters to treat rheumatoid arthritis and breast cancer. The stock trades at a forward P/E of 12, with a 3.9% yield. **Allergan PLC** is now domiciled in Ireland after merging with Actavis. The company sold its generics business to Teva, but still retains eight products, each with over $500 million in annual sales. Flagship *Botox* and other aesthetics products are to a large extent insulated from political risk as they are paid for in cash, not by health insurance. The stock is 28% off its 52-week high and trades at a reasonable multiple relative to future growth.

Your holdings may not include all stocks discussed due to different client inception dates and manager discretion.

U.S. Equity Exchange-Traded Funds (ETF's) – We hold three ETF's as long-term core portfolio holdings. The **SPDR S&P Dividend ETF**, the **PowerShares QQQ ETF**, and the **WisdomTree SmallCap Dividend ETF.** These three complement each other and give us low-cost exposure to different areas of the market. Over the long haul, small cap value stocks like those found in the WisdomTree ETF have been performance leaders. Cash dividends never go out of favor, and the SPDR Dividend ETF owns dividend aristocrats, which are companies that have consistently increased dividends for at least 20 years. The QQQ ETF is designed for capital appreciation with information technology and biotechnology stocks heavily represented.

Actively Managed U.S. Stock Funds – For risk tolerant accounts, we upgraded to the **PRIMECAP Odyssey Growth Fund** last quarter as a replacement for T. Rowe Price New America. This large cap growth fund has an experienced management team, low turnover, below average fees, and a patient, disciplined contrarian growth strategy. Top holdings include Seattle Genetics, Amgen, Alibaba, and American Airlines.

International & Emerging Markets – Following the Trump victory and his appointment of Peter Navarro, PhD., a UCI economics professor, to head the newly created White House National Trade Council, we sold the **Matthews Asia Dividend Fund**. Dr. Navarro has written extensively on China's trade policies. His negative rhetoric and new administration's hard line stance represent a significant headwind for the region and many of the fund's holdings. We are sticking with the **Matthews India Fund** for targeted exposure to the fastest growing economy in the world. Prime Minister Modi took a bold and unprecedented step last quarter by phasing out the two largest denominations of currency. This created short-term turbulence, but will eventually benefit the economy as black market activities decline.

Tax Planning – Expect to receive a Schwab Form 1099 reporting any taxable activity by early February. If you had earned income in 2016, you may be eligible to make a deductible IRA or Roth IRA contribution. Self-employed clients with SEP/IRA's, Individual 401(k)'s, or other company retirement plans may make deductible contributions for 2016 up until their tax filing deadline. Maximizing pre-tax contributions is one of the best ways to accumulate wealth.

Clients over age 70 ½ may designate that their required minimum distribution be paid directly to a charity and avoid income tax. This must be done prior to receiving the distribution.

In Conclusion – Warren and I own many of the same holdings in our self-directed company 401(k) that we hold in client accounts, so our interests are clearly aligned with yours. Our goal is to preserve and build your wealth, and we thank you for that privilege.