BOSTON PRIVATE WEALTH

WWW.BOSTONPRIVATEWM.COM ▪ 1 (800) 422-6172

In This Issue

1 The first quarter of 2016 was a tale of two markets, with the first six weeks reflecting concerns China's slowing economy could potentially trigger a global growth slowdown, while the latter half of the quarter saw investors pile back into risk assets with a fervor.

2 Within the U.S., manufacturing improved, even as consumer activity softened modestly. Employment data indicated labor participation has increased, which should translate to wage growth over time. For now, inflation remains muted.

3 U.S. and emerging market equities closed higher while Japanese stocks weighed on international developed indexes. Bonds gained across the board, with safe haven assets benefiting from increased volatility, and high yield rallying to close out the quarter.

4 We see positive trends in the U.S. economy which should support modest growth through the end of the year. In addition, with near-term volatility at low levels and the U.S. dollar slightly weaker, we believe there is a potential for positive gains in equities.

Economic and Market Perspective

Boston Private Wealth's insights on the quarter's global macroeconomic and market events.

SECOND QUARTER 2016

Global Economic View: Shaky or Stabilized?

As we kicked off 2016, it appeared that the tensions that had boiled over to generate the late summer pullback of 2015 had reached a crescendo once again. The uncertainty sparked by a swooning China, low oil prices, a lack of positive momentum in portions of the U.S. economy, and the overarching concern around how much longer the current bull market could continue against the backdrop of a tightening Federal Reserve proved too much for investors to stand, and as a result, risk assets fell sharply through the first six weeks of the year.

Of course, in the environment in which we exist – of twenty-four hour news cycles tending toward the sensational – it is difficult to separate the transitory from the persistent. Investors who had tuned out during the first quarter could potentially look down at their portfolios as of the end of March and assume it had been a quarter of little activity. By then, fear had been replaced in many instances with complacency. Volatility had subsided. And risk assets, particularly those that had experienced the most relative weakness in the last several pullbacks, were rebounding nicely.

As far as the rationale behind the improved sentiment, there are several motivating factors that brought investors back to the table. Evidence of a firming in what had been relatively soft manufacturing data, dovish statements from the Federal Reserve, continued action from the European Central Bank, and a modest increase in commodity prices all

Boston Private Wealth

Boston Private Wealth offers depth of experience in wealth and investment management, delivering institutional-quality solutions with boutique, personalized service. High net worth individuals, families, and institutions select Boston Private Wealth to manage their wealth.

P: 1-800-422-6172
F: 1-617-502-9422

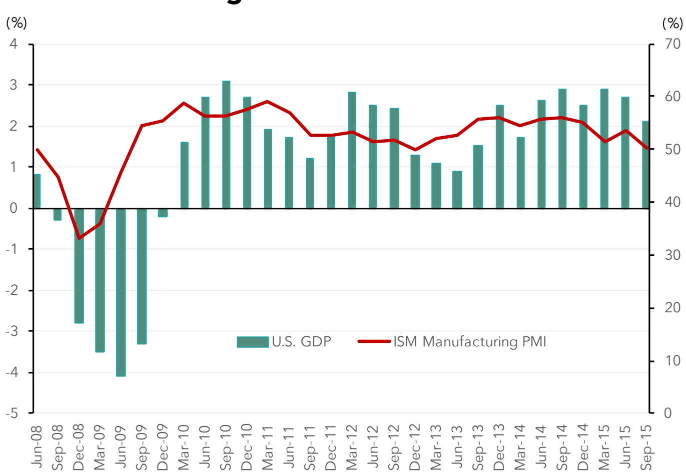
www.BostonPrivateWM.com

helped to get risk assets back on track. While we acknowledge the more positive sentiment, we are cognizant of where we are in the economic cycle, and therefore remain focused on potential inflection points over the next several quarters which could point to a fundamental deterioration in the economy, and thus create a change in our outlook for risk assets.

U.S. Economy: The Grind of Growth

Coming out of the fourth quarter, expectations for the final GDP reading for 2015 were muted at best. Economic data had softened throughout the quarter, as represented by both manufacturing and consumption, and economists were expecting overhang from an inventory build in the first half of 2015 to suppress growth. However, the final reading of +1.4% was better than originally anticipated. While there was deceleration in areas such as non-residential fixed investment, state and local government spending, exports, and inventories, consumption rose by a fairly robust +2.4% – even better than the third quarter +2.2% reading. This strength in consumer spending, fueled by low gas prices and an improving labor market, along with contributions from federal government spending, managed to offset export weakness caused by a strong U.S. dollar.

GDP Remains Rangebound

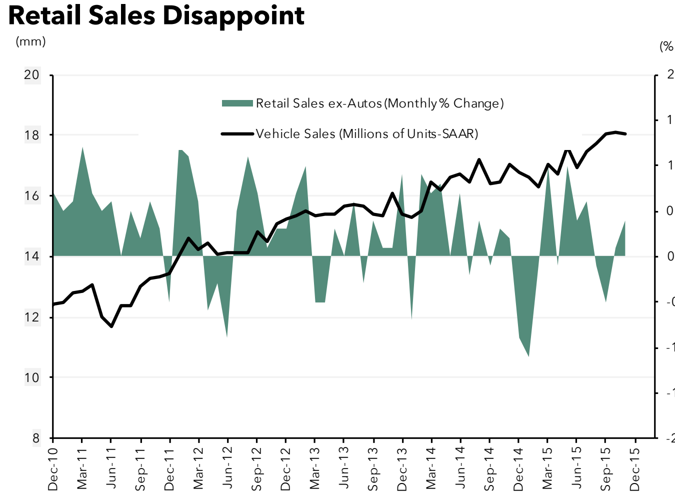


Source: Morningstar

Much of the concern coming into the New Year was centered on weakness in manufacturing. The Institute for Supply Management (ISM) data was contracting, regional output surveys were reflecting the negative impacts of the strong U.S. dollar and lower energy industry spending, and prospects for hiring and new spending were shaky. However, data released in February and March indicate that the bottom may be behind us. For example, the ISM Manufacturing Index rose to 51.8 in March from 49.5 in February, better than the 50.5 reading expected, and the highest since July of 2015. The improvement was in both production and new orders, with exports growing, indicating that demand overseas is improving. In addition, the Philly Fed manufacturing index rose to +12.4 from -2.8 in February, much better than an expected 0.5, and its first positive recording in seven months. This was led by strong readings for new orders and shipments, and a positive move for average workweek data. The Empire State factory index also posted its first positive reading in eight months at 0.6, up from -16.6 in February. Finally, the Conference Board's index of leading economic indicators rose +0.1% in February, the first increase in three months, implying that there is little chance of a recession in the next several months.

Consumption appears to have been hampered by the stock market gyrations experienced in the first quarter. While January consumer spending was initially reported at +0.5%, this was revised down to a feeble +0.1%, matching February's reading. Retail sales, too, were rather disappointing, falling -0.1% in February, while January was revised down to -0.4% from the original +0.2%. Auto sales, which came in at a 17.5 million annualized pace in February, weakened in March, coming in at only 16.57 million vehicles – less than expected. In addition, it appears that there was more discounting in March as a means to drive sales. However, consumer confidence, as reported by the University of Michigan, was only modestly lower in March than in February, declining to 91 from 91.7. Interestingly, there has been little variation in consumer confidence since the second quarter of 2015, reflecting perhaps that while uncertainty around the broad economy influences consumer behavior, the overall financial picture at the household level remains fairly robust.

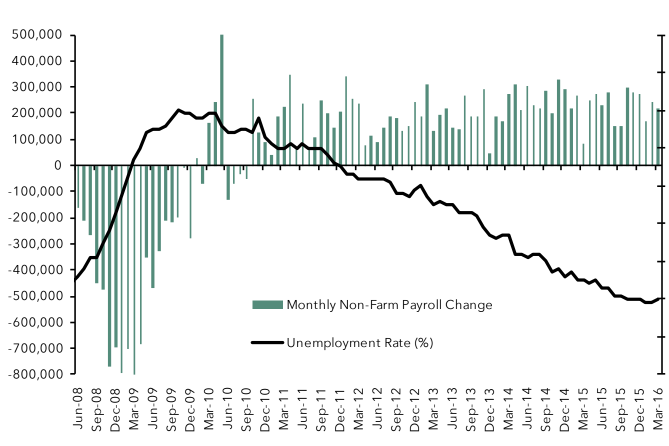
Retail Sales Disappoint



Source: Morningstar

Steady consumer confidence is attributable in large part to the favorable employment environment. As reflected by non-farm payroll and unemployment rate data, the U.S. economy remains on track. Non-farm payrolls in March rose by +215,000, with gains across most of the economy, save mining and manufacturing. Average hourly earnings were higher as well, up +7.0%, or +2.3% annualized. Wage growth could help fuel continued consumer spending improvement. Detracting on the surface from the report was an incremental tick up in the unemployment rate, from 4.9% in February to 5.0%. However, there was a concurrent increase in the labor force participation rate, which at 63% was not only off its historical lows, but at its highest level in almost two years. While admittedly any marked increase in the unemployment rate would be cause for concern, the wage data incorporated in the report is of greater focus to the Fed.

Payrolls Stay Solid

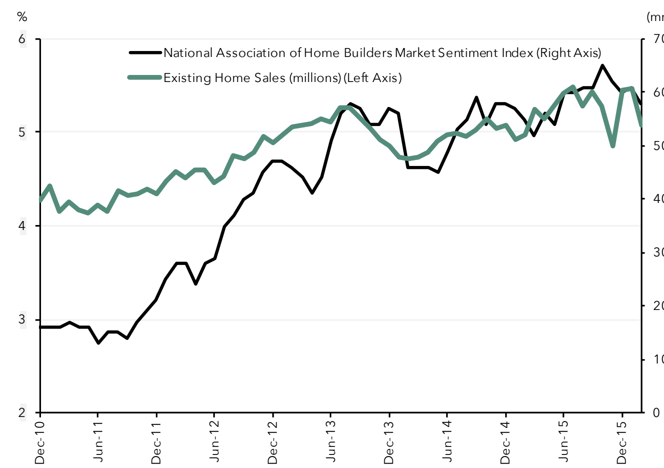


Source: Morningstar

Of course, the dual mandate of the Fed is well known, and employment numbers have been strong for some time; it is inflation that has proved rather elusive. Inflation rose modestly in February, as core CPI (excluding food and energy) was up +0.3% on a month-over-month basis. This increase matched January's reading. Even more importantly, on a year-over-year basis, core CPI was up +2.3%, which marked the largest gain since May of 2012. Driving the increase have been rents, medical care costs, apparel, and new motor vehicles. This reflects the breadth of the increases, while underscoring that food and energy price increases – a major part of consumers' non-discretionary spending – remain muted. Important to note, too, while the CPI figures are above the Federal Reserve's +2% target, their preferred measure – the personal consumption expenditures price index – rose only +1.7% in February.

Housing has shown pricing increases that have been absent in food and energy. Home builder sentiment was essentially flat in March, while U.S. housing starts rose +5.2% in February to 1.18 million units annualized. This marks the highest level since September. U.S. existing home sales fell by -7.1% in February to a seasonally adjusted rate of 5.08 million, much worse than expected after robust December and January data. (December showed growth of +14.7%, the largest monthly increase ever recorded.) The median home price was up +4.4% year-over-year, driven by tight inventories. New home sales were up +2% in February, primarily from activity in the West. Tight inventories, a situation which has persisted for some time, represent the biggest impediment to an increase in existing home sales over the next several months. Anecdotal evidence suggests that prices could continue to rise modestly as potential buyers wait for a more attractive entry point.

Winter Weakness in Home Sales



Source: Morningstar

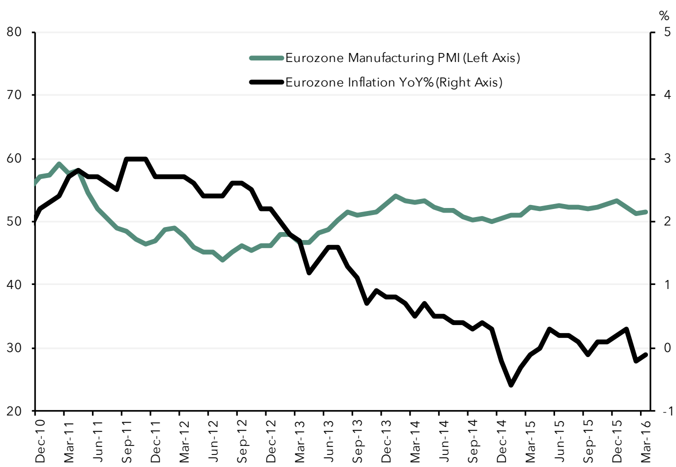
For the most part, Fed governors have been dovish on the back of the December interest rate hike. As expected, the FOMC made no changes to benchmark interest rates in its meeting in early March. In addition, the decision was made to scale back expectations for rate hikes for 2016. Consensus now sits firmly at two interest rate hikes for the year. Changes in the statement indicated that additional risks emanating from around the globe could negatively impact the U.S. economy. In fact, the FOMC revised down its expectation for core inflation to +1.6% year-over-year; that's lower than the current level. The Committee also lowered its growth expectation for 2016 from +2.4% to +2.2%. Finally, with the median expectation for first quarter GDP at only +1.6% – following across the board downward revisions over the last several weeks – it remains unlikely that the Fed will be put in a situation in which they will be forced to accelerate the pace of interest rate hikes beyond what they have indicated.

Developed International Economies: Staying the Stimulus Course

While volatility in the first half of the quarter was taken into consideration as part of the decision-making process of European and Japanese policy makers and central bankers, the reality remains that all parties remain firmly committed to accommodation, and any disruption would only prove to further that pursuit.

From an economic perspective, in the euro area, things are slowly moving in the right direction. For example, in the fourth quarter of 2015, GDP rose +0.3% quarter-over-quarter, or +1.6% on an annualized basis. This marks the 11th straight quarter for growth for the economy. Leading the move higher was acceleration in fixed investment and government spending, up +1.3% and +0.6%, respectively. Consumption and exports also rose +0.2%, but contributed only modestly. European exports remained under pressure as its major trading partners – notably China – have experienced a modest slowdown in investment and consumer demand. Perhaps more important was the modest deceleration in consumption, although that may be a short term anomaly, given evidence of improving employment.

Manufacturing Trends Modestly Higher



Source: Morningstar

Employment, in fact, remains a brighter spot for the European economy. In February, the unemployment rate fell to 10.3%, which marked the lowest level since August of 2011. While there remain pockets of very high unemployment in countries such as Spain, more optimistic job prospects have been cited as a factor for continued consumer gains. Industrial production and manufacturing data, too, appear on an upswing, as the former rose +2.1% from December to January – the strongest monthly performance in six years. Euro area manufacturing PMI, too, increased to 51.6 in March from 51.2 in February. Inflation remains subdued, as low energy prices once again forced CPI into negative territory in March; it was down -0.1% following February's -0.2% print, while core inflation rose only +1.0%. Prices for producer goods sold, a component of the manufacturing report, were also disappointing.

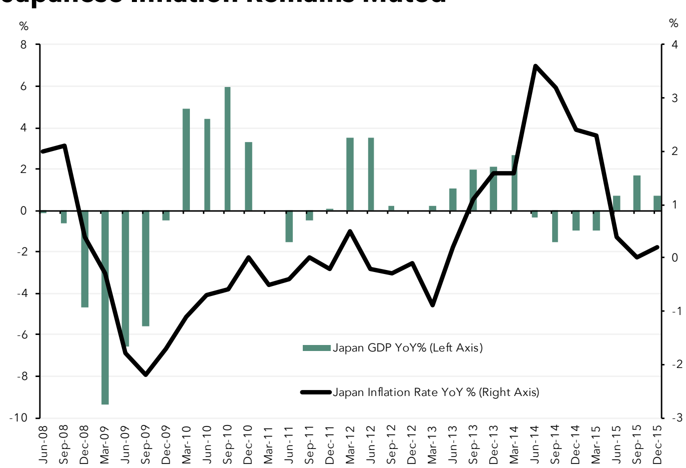
Given the continued softness in inflation, it was all but assured that the European Central Bank would announce additional measures in its March meeting; the magnitude of the measures was the question. The ECB, in this instance, did not disappoint, as ECB President Mario Draghi announced three separate interest rate cuts, an increase in monthly purchases from 60 billion to 80 billion euros, the inclusion of corporate bonds into the purchase program, and four new longer-term refinance operations (dubbed TLTRO II) to begin in June. While markets faltered slightly on Draghi's indication that there would be no further interest rate cuts, the ECB did cut its expectations for both GDP growth and inflation for the next two years, and circumstances will continue to dictate the path of stimulus over that period.

Across the Channel, the Bank of England appears ready, able, and willing to hold firm to its current policies until forced to make a change. In its March meeting, Monetary Policy Committee members held interest rates steady and announced cuts in growth forecasts for the year based on both the most recent budget and on growing fears of a "Brexit." The stance of the BOE remains somewhat at odds with the underlying tenor of the economy, as unemployment held steady at 5.1% in February, its lowest level in almost ten years, and average weekly earnings rose +2.1% in the three months through January's release. In addition, U.K. industrial production rose +0.3% month-over-month in January, led by manufacturing and energy production. This was better than expected and marked a sharp rebound over December's -1.1% decline. The consumer remains engaged as well, as U.K. retail sales rose +2.3% month-over-month in January – the biggest gain in over two and half years – as spending on clothing and computers ticked up. February's release showed a bit of payback for the reading, but the decline of only -0.2% was much better than expected, and represented a +4.1% year-over-year gain. Yet, there are reasons for the BOE's cautiousness. Unlike the U.S. and Japan, where government spending is increasing, U.K. fiscal policy remains fairly tight. In addition, with the June referendum proposing an exit of the U.K. from the European Union looming, there could be additional volatility and nervousness in both the economy and asset markets, and a move to tighten at this juncture would only compound that in the near to mid term.

The Japanese economy continues to flounder. Fourth quarter GDP contracted, falling -1.1% on an annualized basis primarily a -0.9% decline in consumption as fixed investment rose by +1.1%. Exports, too, have been weaker, but there is some evidence of improvement, as the trade deficit narrowed in January, and February's exports fell by only -4% year-over-year – a significant improvement from January's -12.9% decline. Consumer prices excluding fresh food, the traditional gauge for inflation in Japan, were flat for a second month in February, and even when energy and food were stripped out, the measure still grew a paltry +0.8%.

The Bank of Japan took an unprecedented step in January to cut a benchmark interest rate to -0.1% as yet another step to try and revive growth in the country's economy, in part by accelerating the pace of inflation. However, minutes from the BOJ's March meeting indicated that central bank board members were already concerned that the move had very little positive effect on the economy, and that perhaps the adoption of the unorthodox move would prove to do more harm than good. Either way, with Governor Haruhiko Kuroda committed to delivering +2% inflation growth by the end of the year, against the backdrop of what is slated to be another 2% increase in the sales tax, there is the potential for a very real crisis of confidence brewing in the latter half of 2016.

Japanese Inflation Remains Muted



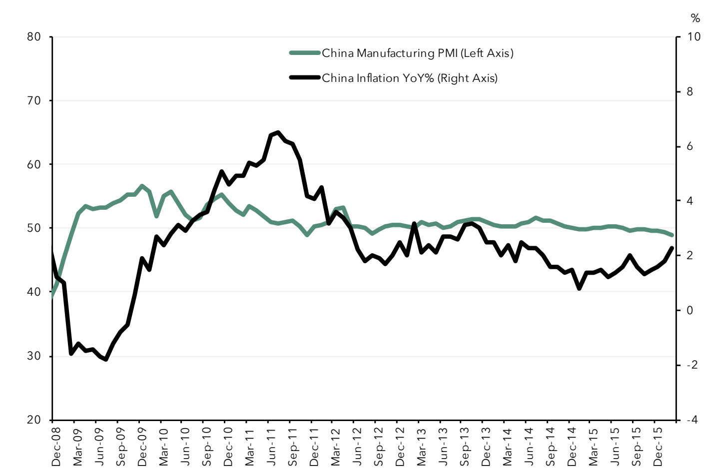
Source: Morningstar

While the overarching stance of central bankers in developed international markets remains accommodative, the relative success of these policies remains closely tied to an eventual improvement in demand from China and other trading partners. Structural changes are necessary in Japan, while fiscal cooperation is critical in Europe. A move by the United Kingdom to exit the European Union would increase uncertainty in the region, and could have ripple effects on the global economy that bear worth watching.

Emerging Market Economies: Changing China

Similar to events that unfolded last summer, China's economic weakness was one of the major factors that precipitated the declines experienced in equities markets to begin the year. The Chinese economy was little changed in the fourth quarter from where it had been. Notably, GDP grew by +6.8%, resulting in 2015 growth of +6.9% overall. Driving the growth has been, not surprisingly, the Chinese services sector, which grew by +8.3% last year, while manufacturing slowed to +6.0%, down from 2014's +7.3%. An underwhelming contribution from manufacturing is what continues to spook investors who are looking at the relative opportunities in China in the near term. All major measures of the manufacturing economy have been soft over the last few months. However, China's official manufacturing purchasing managers index rose to 50.2 from 49 in February. This marked the first time the reading was over the 50 mark, indicating expansion, in eight months. Non-manufacturing PMI, too, showed improvement, rising from 52.7 in February to 53.8 in March.

Chinese Demand Remains Dim



Source: Morningstar

Industrial profits rose +4.8% year-over-year in the January to February time period, marking the first such improvement in eight months, and much better than the -4.7% decline posted in December. Fixed asset investment, too, was incrementally stronger, rising +10.2% in January-February on a year-over-year basis. Disappointing were the factory output and retail sales releases, with the former up only +5.4% year-over-year, its lowest since November 2008, and the latter up +10.2% - the lowest since May of 2014.

Also plaguing the China has been the significant pressure on its currency, and efforts by the People's Bank of China to support the yuan have resulted in a drain on the country's reserves. However, as volatility waned over the last several weeks and policy makers have become more comfortable with the comparison of the yuan to a basket of major currencies, concerns around a sharp decline in reserves has abated.

Perhaps most supportive have been policy announcements which indicate that the Chinese government and the PBOC are both committed to stabilizing the economy. Measures announced include a 3% target for the budget deficit – higher than the 2.3% 2015 target – as well as a decrease in reserve requirements by 50 basis points in February to 17%. While these measures have provided some necessary stabilization, the reality is that the Chinese economy is clearly pivoting, and the policy adjustments which will be required may create uncertainty among investors over the next several years.

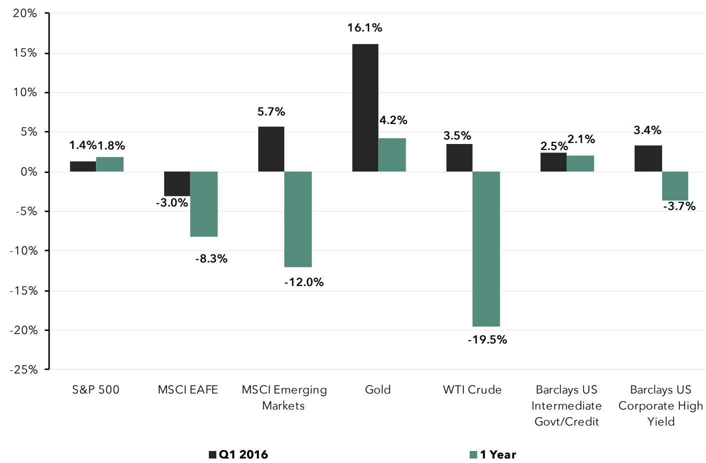
We believe that the global economy can continue to post growth in the near to mid term. The U.S. economy is unlikely to slip into recession this year; therefore, we expect consumption and investment to create a scenario in which we experience modest GDP growth. Europe lags the U.S., but provided there is stabilization in end market demand from China, the positive trends in the euro zone economy should continue through the rest of this year.

Global Markets Review: A Wild Ride

While fears of a hard landing in China and a slowdown in the global economy at large saw investors swap risk assets for safety in the first six weeks of the year, that trend largely reversed in the second half of the quarter. Indeed, in a pattern very similar to last year's sharp decline in August, volatility increased markedly, only to meet with resistance and eventually capitulation, creating complacency to close the quarter.

Domestic large cap equities, as represented by the S&P 500 Index, experienced quite the fall and subsequent rise in the first quarter. In fact, a number of dramatic moves in the first two months of the year – in which the S&P gained or lost 1% on 26 of 48 trading days – led way to a much sleepier March, in which the index moved by 1% only 3 times, and closed up almost +7% for the month, wiping out losses in January and February. From a sector perspective, defense was the best offense in the quarter, as telecommunications and utilities far and away posted the strongest performance, posting gains of +16.4% and +15.5% respectively. Health care stocks continued to languish, as concerns around valuations, fears of increased government involvement, and some high profile company-specific issues resulted in a loss of -5.1% for the sector.

Emerging Markets Catch a Bid

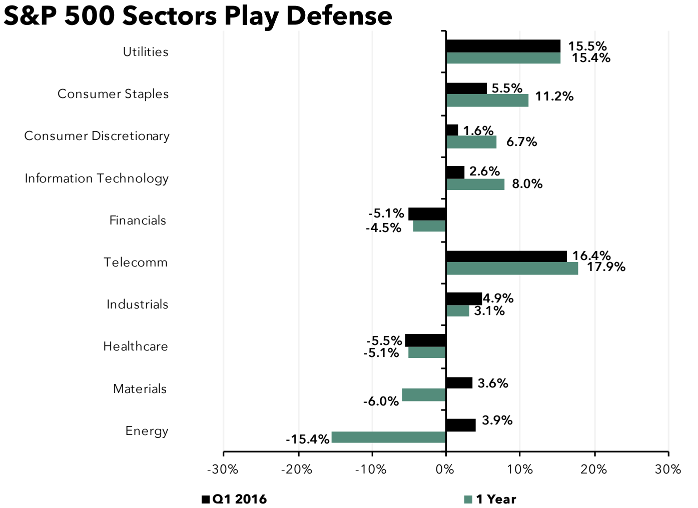


Source: Bloomberg, Morningstar

Financials, too, underperformed, as a dovish Fed has cut near term expectations for bank earnings improvement.

From a style standpoint, value names across the capitalization spectrum outperformed growth names. While U.S. small cap stocks markedly underperformed mid and large cap names as a whole, small cap growth names were by far the worst place to be in the first quarter for investors in U.S. equities, underperforming even the energy correlated and therefore challenged MLP space. While value stocks could continue to outperform, the value bias may remain muted in the large cap space until energy and financial stocks breakout from a leadership standpoint.

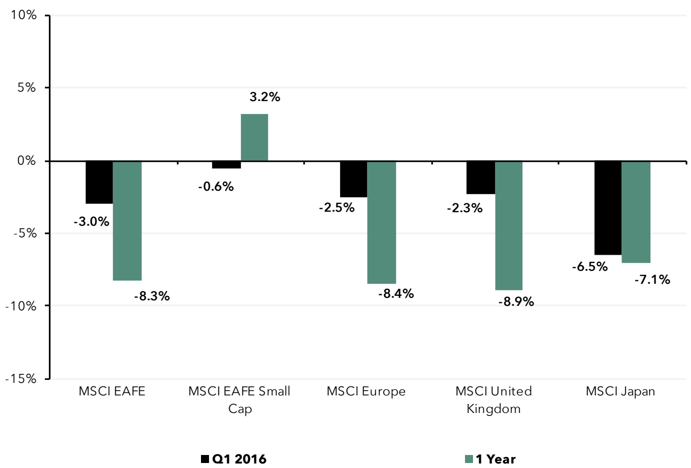
S&P 500 Sectors Play Defense



Source: FactSet

Outside of the U.S., in developed internationals markets, small cap equities markedly outperformed large cap names in the quarter, and particularly in March – as they did all of last year. This outperformance came even in the face of significant underperformance by Japanese stocks, which experienced sharp declines across the board as concerns increased around Prime Minister Shinzo Abe's ability to pivot the Japanese economy against the backdrop of challenging demographics. In addition, with relatively weak Chinese import demand, Japanese companies stand to struggle, especially if the yen appreciates relative to the euro. European and U.K. stocks underperformed U.S. names as well, albeit by a smaller margin than Japanese names.

Japanese Stocks Disappoint



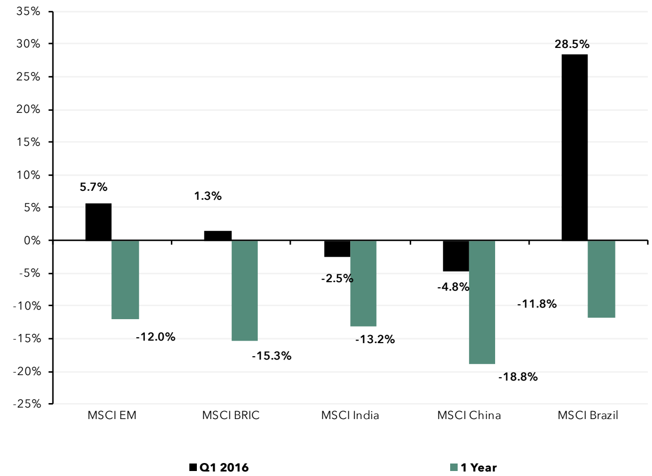
Source: Morningstar

Important to note, U.S. dollar weakness has mitigated some of the equity declines in international markets for U.S. investors; as compared with last year's increase in the dollar of over +9% (against a broad basket of currencies), the dollar was actually down roughly -4% for the first quarter.

Emerging markets names capped off the first quarter well ahead of any other broad equity segment, enjoying a strong rally after several years of lackluster performance. Driving the performance of emerging market equities in the quarter were improvements in global manufacturing data and commodities, along with the adoption of a fairly dovish stance by the Fed – all of which made the U.S. dollar a little less attractive. In addition, Brazilian stocks experienced a significant gain in the quarter as it became more likely that President Dilma Rousseff will be unable to avoid impeachment; neighboring markets have also benefited from the potential power shift.

Other areas of strength included Eastern Europe and Africa, both areas which stand to benefit from improved prospects for foreign investment. Asia, and particularly China, did not participate in the first quarter rally, as the positives outlined above were not enough to trump the lingering concerns around Chinese demand.

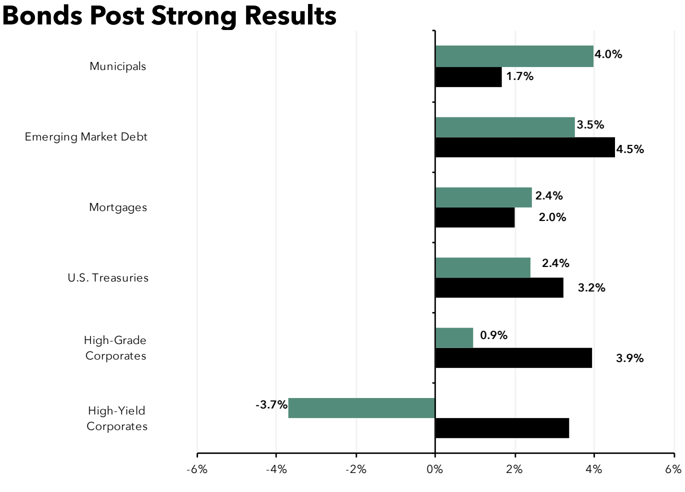
Brazil Buoys the Benchmark



Source: Morningstar

All major fixed income assets classes managed to post gains in the quarter, albeit for different reasons. While U.S. Treasuries benefited early on the flight to safety, high yield bond performance mirrored the moves in the equity markets, with energy names in particular experiencing a roller coaster ride. For instance, through the middle of February, high yield energy names were off almost -17%, but managed to rally back with oil by almost +26% through the end of March. Not surprisingly, downgrades in credit have accelerated, and this is likely to continue as the risk of default picks up for strapped commodity and energy-exposed issuers. Despite downgrades, flows remained robust into high yield bonds, and new issuance for relatively stronger companies in the space has picked up.

Bonds Post Strong Results



Source: Morningstar

Investment grade corporates were fairly consistent in the quarter, with spreads widening only modestly amid some of the early quarter volatility. Issuance from high quality companies has been fairly robust, and it has been met with brisk demand from investors. Municipals, given their dynamic as a more retail asset class, tend to react more slowly to changes in policy and market dynamics, and as such, posted more muted returns in the quarter. At quarter end, municipals remain reasonable vis-à-vis Treasuries, and are more attractive at the longer end of the curve.

Finally, within real assets, commodities remain challenged as global demand remains underwhelming. As one would expect, the market swoon of the early part of the quarter pulled most commodities down with it. However, the second half of the quarter brought a nice rebound, and some areas of the commodities complex posted very strong gains, such as gold and silver, up +16% and +11% respectively. WTI crude also enjoyed a nice rebound in the quarter after falling down to $26 a barrel, and closing at almost $40 to end the month of March. Copper managed to eke out a quarterly gain, up +1.9%, while agricultural commodities were essentially flat. While commodity prices may remain hamstrung by relatively weak global demand, energy prices may experience some firming as suppliers look to potentially curb output. REITs performed extremely well in the quarter as interest rates – and in turn, the cost of borrowing – remain historically low.

Second Quarter Outlook: Where to?

As we move forward into the second quarter, we continue to see positive trends in the U.S. economy which should support modest growth through the end of the year. In addition, with near-term volatility at low levels, and the U.S. dollar slightly weaker, we believe there is a potential for positive gains in equities, here in the U.S., but perhaps even more so in international developed and emerging markets. We remain focused on the fact that much of the positive impact of lower energy prices, stabilization in the European economy, fiscal and monetary accommodation in Japan, and an increase in government spending here in the U.S. have yet to transmit to the markets. In addition, with PMIs improving and P/Es expanding, we expect to see improvement in corporate earnings over the next several quarters. With that as our thinking, we will continue to look for ways to better position your portfolio to capture the potential for growth, while remaining thoughtful and consistent in our willingness to take an appropriate amount of risk. As always, we maintain our steadfast commitment to you, our clients, working to preserve and grow your capital in order to meet the goals and objectives you have set for us.

1 Federal Street, Boston, MA 02110 ▪ **P** (561) 223-0200 ▪ **F** (561) 630-9788 ▪ www.BostonPrivateWM.com