Investment Update

April, 2016

2016 First Quarter Update

Review: Despite falling 10% during the first six weeks of the quarter, equities rallied and managed a small 1.4% gain. Developed international equity markets fell 3.0%. However, emerging markets gained 5.7%, as they continued to recover from a 14.9% decline in 2015. Domestic bonds rose 3.0% for the quarter as investors became convinced that interest rates would remain "lower for longer."

Period	1Q16	4Q15	3Q15	2015
S&P 500	1.4%	7.0%	-1.4%	1.4%
EAFE*	-3.0%	4.7%	-0.8%	-0.8%
Emerging Markets	5.7%	0.7%	-17.9%	-14.9%
Barclays U.S. Aggregate Bond	3.0%	-0.6%	1.2%	0.6%

*Europe, Australia, Far East

Domestic Economy: Once again, U.S. economic growth slowed to 1.4%, compared to 2.0% in the third quarter (the most recent data available). Healthy consumer spending (+2.4%) was offset by weaker exports due to the strength of the dollar. Other indicators of the domestic economy, including job creation (averaging 200,000 new jobs per month), retail sales ex-gasoline, and housing starts, point to a resilient U.S. economy.

For this year, we expect the U.S. economy to grow modestly at 2.0-2.5% based on continued strength in the job market. Wage growth, which would aid consumer spending, should increase in line with GDP growth.

International Economies: With 10% unemployment, growth in Europe is forecast at about 1.5%, spread unevenly over the European states. The most recent dose of stimulus supplied by the ECB has had limited effect thus far in lowering unemployment. The Eurozone faces a number of distractions over coming months that will make it difficult to focus on economic issues, including the ongoing refugee crisis, possible UK exit ("Brexit") from the community, and another milestone in the Greek financial crisis. Japan continues to stagnate due to an aging (and shrinking) population. Stimulus from the Bank of Japan has not yet been effective in boosting the economy. Some important emerging economies, notably China, are showing signs of stabilizing. Others, like Brazil and Russia are mired in recessions. We conclude that emerging economies

600 Atlantic Avenue
18th Floor
Boston, MA 02210-2211

Phone: 617-357-5101
Toll-free: 800-357-5101
Fax: 617-357-7199

info@middletonco.com
www.middletonco.com

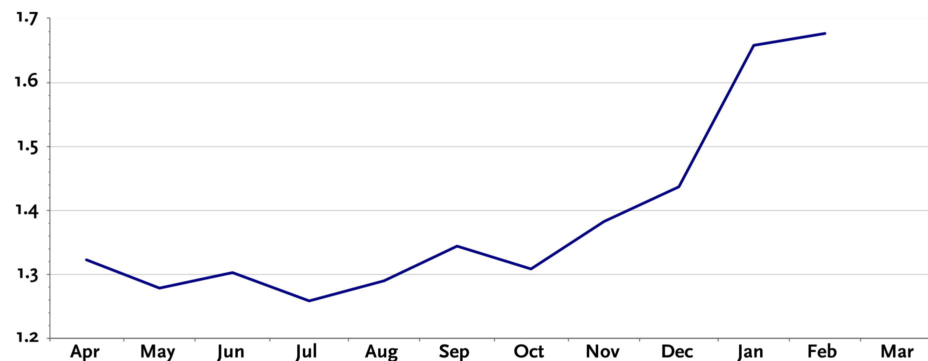
will not be the vigorous engine of growth for the world economy that they have been in the past.

Strategy: We believe that, globally, equities will provide better returns than fixed income over the next year, assuming central bank stimulus finally begins to boost economies. Given relatively good prospects for the U.S. economy, we favor U.S. stocks over international stocks where growth is more modest and less certain. We expect equity returns will likely match the mid-single digit increases we project for earnings.

While we believe equities offer upside, bonds are overvalued. The ten year Treasury note yields about 1.7% which is barely enough to keep up with the current 1.7% inflation rate. Given low interest coupons, bond prices will be very sensitive to even small interest rate increases. Although the timing of rate increases in the U.S. is the subject of debate, we expect one or two additional increases by year end.

As shown in the chart, core inflation, a key measure for the Fed, is beginning to tick up. While the latest reading, +1.7% is below the 2% level that could spur the Fed to increase rates, the trend bears watching, especially since the two largest components, housing and healthcare, are increasing well above a 2% rate.

Core Personal Consumption Expenditure Inflation



Our equity strategy emphasizes consumer, healthcare and technology stocks. Consumer stocks should benefit from rising consumer spending due to the improving job market and wage increases. The aging population and a high level of innovation make health care stocks attractive investments. Technology innovation, including web applications and mobile devices are having a profound impact on many segments of our economy and should support attractive growth rates for select stocks.