THE BOSTON FAMILY OFFICE

Investment Update

First Quarter 2016

Recap

The US stock market ended the first quarter roughly where it ended 2015, but once again covered significant ground during the period. In December, the Federal Reserve raised short- term rates for the first time since 2006 and indicated that it expected to raise short-term interest rates four times this year. Many investors were concerned that this intended policy would be inconsistent with what continues to be a muted economic recovery in the US and a weakening global economy. Coupled with the price of oil continuing to slide, a stronger dollar and ever-present worries about the strength of China's economy, the S&P 500 closed on February 11th down 10.52% year-to-date with other risk assets seeing similar losses. Fed speakers began to back off of the four rate hike rhetoric and the stock market steadily regained ground through the next seven weeks to end the quarter up slightly and roughly 13% above its lows.

Equity Markets (Total Returns)	**1Q16**	**1-Year**
Dow Jones Industrials	2.20%	2.08%
S&P 500	1.35%	1.78%
S&P Mid-Cap	3.78%	-3.60%
S&P Small-Cap	2.66%	-3.20%
MSCI All-Country World	-1.37%	-4.36%
MSCI Foreign Developed Markets	-1.81%	-4.01%
MSCI Foreign Emerging Markets	2.78%	-7.36%
US Bond Markets (Total Return)	**1Q16**	**1-Year**
Barclays US Gov't/Credit Intermediate	2.45%	2.06%
Barclays US Gov't/Credit Long	7.30%	0.39%
Barclays Municipal Intermediate	1.55%	3.73%

Commentary

You can see from the price chart of the last two years on the next page that despite periods of considerable volatility, the S&P 500 has traded in a band between roughly 1800 and 2100. Although it had already done so twice during that period, we did not feel at any point that compelling case could be made for stock prices to correct by much more than 10%, and once again, by February we thought that the market's decline had more than appropriately discounted the issues facing it. As had been the case with last two rapid selloffs, the speed with which markets recovered from the February lows was surprising.

While investors collectively lack the conviction in the bearish world views necessary to take the S&P 500 any lower than 1800, it is also constrained on the upside by valuation anywhere near 2100. As mentioned in the past, low inflation and interest rates can support above average price/earnings ratios, but we do not think that stocks are particularly cheap now given the challenging earnings environment. We would be surprised to see more than low single-digit year-over-year earnings growth because revenue growth is hard to come by, and profit margins are already at historic highs that will be difficult to improve upon.

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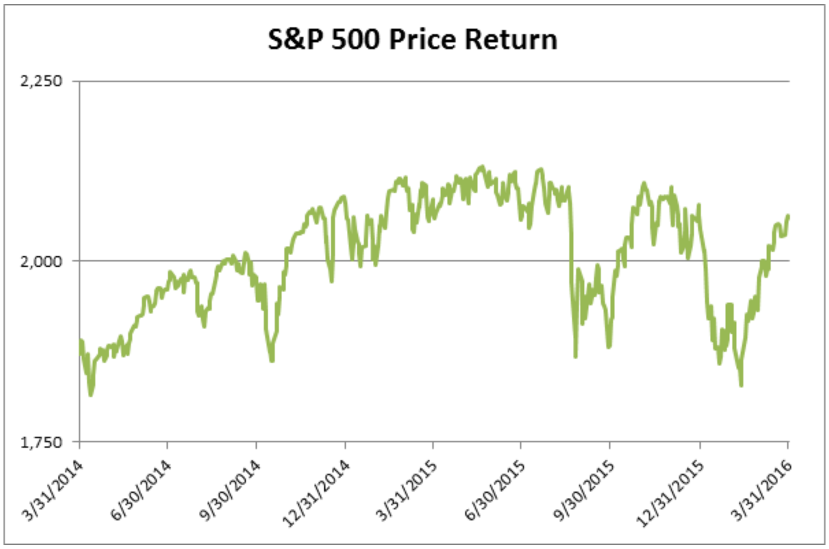
From here, return expectations should be tempered even though investments in stocks are quite likely to outperform bonds over the medium to long-term. After the S&P 500 returned between 14% and 32% in 2012, 2013 and 2014, the market could be thought of as correcting in time by not making any net upward progress over the last fifteen months, rather than by correcting by going down. This trend could continue throughout 2016.



Much of this volatility, both up and down, is likely exacerbated by the volume of trading that is driven by short-term momentum investing where stocks might be held only for weeks, or even fractions of seconds, whereas we look for stocks we can own for many years. Having the conviction to stay the course in such an environment is made more difficult by the oft-hysterical headlines in the media, of which there have been no shortage this quarter. We strive to both tune out the noise, and understand our clients' temperament and any possible needs for short-term liquidity so that we can employ an appropriate asset allocation for each situation. This should enable us to do no more than possibly look for buying opportunities in the event that the market has a sudden 10% drop.

The market is said to hate uncertainty and perhaps the most dynamic (used without any of the possible positive connotations) current variable is the Presidential election. We do not need to tell you that the primary season has been one of the most bizarre in memory. Even if there was a more usual level of certainty at this point in the cycle about whom the nominees will be, one cannot start to contemplate the stereotypical economic scenarios in the event of a Democratic or Republican win because several remaining candidates are not orthodox representatives of their respective party's thinking. Thus we are hearing less talk of the need to start positioning portfolios in this way or that given the possible outcomes. Once the general election is over, there should at least be more clarity on the direction of capital gains tax rates which could suggest a strategy of accelerating or delaying the realization of capital gains.