Quarterly Update & Economic Commentary—March 31, 2015

Quarter in Review

The first quarter of 2015 marked the ninth straight quarter of positive returns for the total return of the S&P 500. Although the total return was a modest 0.95 percent, other categories of the market performed better. The S&P MidCap 400 returned 5.31 percent while the S&P SmallCap 600 returned 3.96 percent on a total return basis. Domestically, growth indices outperformed value indices by a significant margin. The difference in performance between growth and value ranged from around three percent in large cap to over five percent in small cap. International equities also performed well during the quarter, with the MSCI EAFE NR, a proxy for international developed countries, returning 4.88 percent and the MSCI EM NR, a proxy for emerging markets countries, returning 2.24 percent, respectively. U.S. investors holding foreign investments continued to be hurt by the strengthening dollar. The difference in return between a U.S. dollar-denominated investor and a local currency investor in the EAFE was around six percent and around two percent in the emerging market index.

Interest rates had a volatile quarter. The typical benchmark for rates, the 10-year treasury yield, began the quarter yielding around 2.20 percent, dropped to a closing low of 1.67 percent by the end of January, only to rebound in February and the beginning of March to 2.26 percent before closing the quarter back down at 1.93 percent. It may have been a difficult ride for fixed income investors, but the 24 basis point drop in yields through the quarter benefited bond investors. The Barclays US Aggregate Bond Index returned 1.61 percent, while the more risky Barclays US Corporate High Yield index gained 2.52 percent, both on a total return basis.

Most commodity prices fell for the quarter. Oil prices continued to decline as inventories rose, the dollar strengthened and global economic growth remained low. One of the lone bright spots was silver which gained six percent. Other precious metals did not perform as well; gold was flat, copper fell four percent and nickel lost 18 percent. Most commodities are priced globally in dollars which causes pricing pressure when the dollar strengthens.

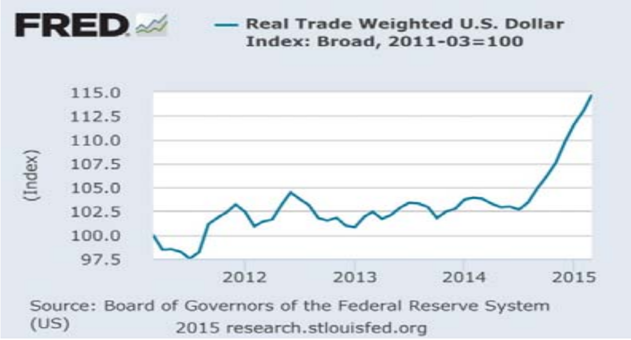
Central banks globally have continued to intervene in the markets, causing market participants to pay close attention. The European Central Bank (ECB) finally stopped discussing a quantitative easing (QE) policy and announced that it would embark on such a measure. ECB President Mario Draghi announced that the central bank would begin purchasing 60 billion euros a month of public and private assets beginning in March and running through September of next year. The program could be extended if needed. The massive bond buying - which is larger than many expected - is expected to drive interest rates lower, fight off deflation and increase economic growth.

As the ECB embarks on its new stimulus program, the U.S. Federal Reserve is considering raising interest rates for the first time since 2006. In the Fed's recent announcement at the conclusion of its scheduled meeting, the word "patient" was dropped from the language when referring to when the Fed would raise rates. The dropping of a word from the language may not seem like a significant detail to many, but it was a step that needed to be taken before the Fed would actually begin to raise rates. The Fed stated that it was possible to see a rate increase at the June meeting. Fed Chair Janet Yellen did emphasize that the Fed would remain data dependent and that there was no set schedule to begin raising rates.

In addition to the ECB's new program, Japan continues with its aggressive monetary stimulus, leading to continued currency devaluation and a rally in the Japanese stock market which reached a 15-year high. Falling energy prices have helped to reduce inflation fears in many countries, allowing central banks to cut rates in an attempt to stimulate economic growth. Some of the countries that have cut rates include South Korea, China, India, Poland, Indonesia, Switzerland and Sweden.

The U.S. economy continues to grow; however, some recent disappointing readings have raised concerns around the strength of the U.S. economy. Despite lower oil prices and rising personal incomes, retail sales data and durable goods orders have disappointed. Fourth quarter GDP, announced during the first quarter, showed the U.S. economy grew at a pace of 2.2 percent, which is not a concerning figure considering the previous two readings were strong at 4.6 and 5.0 percent, respectively. The U.S. economy is not growing at four-to-five percent annually so a drop for a quarter or two should not be surprising or concerning. The employment picture is far from strong but continues to show signs of improvement. The unemployment rate is at 5.5 percent. The four-week average of weekly jobless claims continues to fall and total nonfarm job openings are on the rise.

Many U.S. companies, especially the large multi-nationals, have been negatively impacted by the strengthening U.S. dollar (see chart below for an illustration of how the dollar strengthened.) Operating earnings for the fourth quarter saw a significant quarter-over-quarter decline. Companies are now, more than ever, being evaluated based on where their earnings are coming from. FactSet recently looked at quarterly performance of all the companies in the S&P 500 through March 26th and found that the average price change for companies with more than 50 percent of sales in the U.S. was positive 1.5 percent while the return of companies with 50 percent of their sales outside of the U.S. was negative 1.8 percent.



A LOOK AT THE NUMBERS

Name	1st Quarter 2015 (%)	Year-to-Date (%)
DJ Industrial Average TR USD	0.33	0.33
S&P 500 TR USD	0.95	0.95
S&P MidCap 400 TR	5.31	5.31
S&P SmallCap 600 TR USD	3.96	3.96
NASDAQ Composite TR USD	3.79	3.79
MSCI EAFE NR USD	4.88	4.88
Barclays US Agg Bond TR USD	1.61	1.61
Wilshire US REIT TR USD	4.67	4.67
IA SBBI US 30 Day TBill TR USD	0.00	0.00

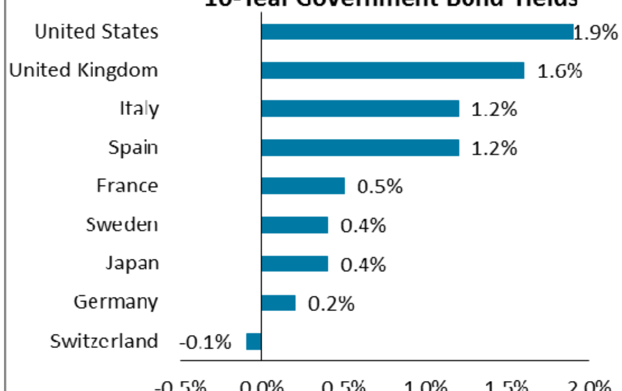
FORECAST IN BRIEF

The beginning of the second quarter will likely see a continued trend of disappointing economic news coming out of the U.S. Many of the disappointing readings will be backward looking, like the first quarter GDP release that may show that the U.S. economy grew at an annualized pace of one percent or less. Given that these negative numbers are expected, the markets will focus on monthly readings for indications that consumers are more willing to spend and that the recent slowdown is temporary or weather related.

Corporate earnings are also expected to disappoint as a number of companies should continue to be hurt by the significant rally in the U.S. dollar and the sharp decline in oil prices. According to FactSet, the year-over-year earnings of the S&P 500 is expected to decline by 4.6 percent, which would be the first decline since the third quarter of 2012. Interestingly, the last time the S&P 500 had a negative quarterly return was the fourth quarter of 2012, which is when third quarter earnings were announced. A big contributor to the projected decline in earnings is the energy sector which is expected to see a year-over-year decline in earnings of around 64.2 percent. If the energy sector was excluded, the estimated growth rate for the S&P 500 would change from -4.6 percent to 3.4 percent. In previous quarters companies have been lowering expectations, only to over-deliver; we expect this to continue with a better than anticipated earnings season for the first quarter.

The Fed's June meeting will be closely watched as it is a potential time for an interest rate hike. The Fed may use weak economic news, a strong dollar, low oil prices and weak wage growth as an excuse to delay a rate hike until later in the year. We do not believe this initial rate increase will have much impact on the economy or stock market, except maybe for some short-term volatility around the announcement. We continue to expect the yield curve to flatten as short-term rates rise and long-term rates fall as foreign investors continue to purchase longer dated U.S. treasuries because of the attractiveness compared to other sovereign issues. Long-term U.S. treasuries

10-Year Government Bond Yields



Source: Bloomberg as of 03/31/15; Eaton Vance Monthly Market Monitor, April 2015

will be anchored to other sovereign debt which will be kept low as a result of central bank intervention.

An indicator that could reverse the long end of the curve from falling is an increase in inflation expectations which could occur if wages show a meaningful increase. We are beginning to see upticks in wage growth, and many of the largest hourly employers have announced they will increase wages, including corporate owned McDonald's locations, Walmart, Target, and TJ Maxx to name a few.

Spring time is the unofficial kick-off to the home buying season. With mortgage rates low and consumer confidence on the rise, one would expect to see an uptick in home sales. A lack of supply, however, will push home prices higher and limit transactions. The rise in home prices may hurt potential buyers but it is a good thing for home owners, both those looking to sell and not looking to sell. Home values make up a large percentage of a family's net worth, and as home prices increase, confidence increases and discretionary spending should increase and help the economy.

We expect to continue to see central banks across the globe trying to de-value their currencies through quantitative easing in places like Europe and Japan and rate cutting in many other countries, including emerging market countries. Economic growth began to pick up in Europe towards the end of the quarter, but future growth is far from certain. Low rates and a cheaper currency may help, but Europe's issues go much deeper. The threat of Greece's departure still looms, and it will remain until some sort of structural reform occurs. We do not believe a Greece exit, in and of itself, would be catastrophic, however, it could set the precedent for another country to leave the Euro, like Spain or Italy. An exit by one of the larger countries could cause problems for markets.

There has been a lot of attention on the negotiations with the Iranian nuclear deal. Part of the deal will most likely include the lifting of sanctions, which could result in Iran adding to the global supply of oil. As we have seen, the excess supply around the world has contributed to the drop in oil prices. Many believe that a deal being struck, which is expected at the end of June, would put further pressure on oil prices. Even if the sanctions are lifted, we do not expect to see the extra Iranian oil hit the market until at least the middle of next year. As a result we do not expect to see an immediate impact. The Iranian negotiations may have some political impacts as well, as many democrats have been publically expressing their disapproval of the way the President is handling the situation.

U.S. investors with holdings in many emerging market countries have been hurt by the strengthening dollar which is expected to continue as speculation around a Fed rate hike continues. The dollar has risen considerably against the currencies of Brazil, Malaysia, Indonesia and Turkey. If oil prices remain low and central banks in these countries are able to continue to be accommodative, the currency pressure is expected to continue.

The impacts of lower oil prices and central bank involvement have hijacked the headlines and have caused an increase in volatility. Over the short term we still feel that lower oil prices and interest rates will benefit U.S. consumers. We expect to see a pickup in economic activity during the second quarter and into the summer, driving stronger economic growth in the second half of the year. The stronger dollar will have an impact on multi-national companies, but these companies will adapt by mitigating the impact that a stronger dollar can have on their businesses. Domestic small and mid-cap stocks that have less global exposure should benefit in this environment. Depending on your risk tolerance, owning international stocks to some capacity makes sense; however, much of the recent gains may be attributable to speculation and hope that central banks can fix the structural issues. Because of the growing risks and complexities involved while investing internationally, it is important to not chase returns and be selective in the investment process.

If anything in your financial situation has changed, please let us know so that we can determine whether a change in your portfolio is necessary.

— Robert Moyer, CFA, CFP®, CAIA
Director of Research

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