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QUARTERLY SUMMARY
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Issue: Fourth Quarter, 2015

Review of Securities Markets, Fourth Quarter, 2015

Stocks recovered from September lows with the Standard & Poor's 500 registering a gain of 7% in the last three months of 2015. The lift was just enough to end the year with positive returns of 1.4%, but this was the lowest performance for the index since 2008. Large company and growth stocks including health care, technology, and consumer-oriented issues performed better than small and value stocks. REITs also outperformed other equities in this low interest rate environment. Economic conditions in the United States continued to improve, with steady job growth pushing the unemployment rate down to 5%, the most promising level since the end of the most recent recession in 2009. Unfortunately, wage growth was sluggish and labor force participation remained abysmal, a sign that there is still more work to do on the economic recovery.

During the fourth quarter, foreign stocks did not perform as well as U.S. stocks, rising 3.24%. Developed market stocks increased 4.75% during the quarter, as measured by the MSCI EAFE Index. Emerging markets managed to eke out a 0.66% positive return in the fourth quarter, not enough to recover the 14% decline recorded in the first nine months of the year. A slowdown in China was a focal point for investors, but emerging economies suffered from a number of problems. Weakening oil prices hurt developing nations that are dependent on the export of energy products. A strengthening dollar punished those nations who borrowed heavily in U.S. dollars. A stronger dollar makes the debt service more burdensome for economies that are already facing weakening global demand.

Investors anticipated an increase in rates during the quarter and the Fed did not disappoint. After its December meeting, the Fed announced a 0.25% increase in the Fed Funds rate, pushing it above zero for the first time in seven years. Federal Reserve Chairwoman Janet Yellen provided a very encouraging view of U.S. economic growth accompanied by a patient stance on future rate increases – a modest prognostication that met investors' expectations. Short-maturity bonds declined slightly as rates rose during the quarter. Municipal securities benefited from strong demand and a low level of new issuance. These bonds performed better than taxable issues despite the rate increase. Junk bonds suffered as investors flocked to high-quality bonds, similar to those generally owned in BOS-client portfolios. The sell-off in junk bonds intensified during the quarter after a mutual fund stopped shareholder redemptions so the managers could initiate an orderly liquidation of the fund.

A Year in Review

The steadily-rising U.S. stock market of the past few years continued into 2015, with the Nasdaq Composite and S&P 500 hitting all-time highs early in the year. Improving employment and a stabilizing housing market contributed to investors' rosy outlook. Mid-year the market displayed a higher and more normal level of volatility, some of it attributable to China's currency devaluation, an attempt to make Chinese exports more affordable overseas. This move was a surprise to investors and heightened concerns that China would not be able to engineer a soft-landing for its weakening economy. Investors became concerned that the world's second largest economy, once growing at double-digit rates, may no longer be the world's engine of growth. Oil prices suffered as a result, falling dramatically during the second half of the year as global supply outstripped demand. This, in turn, impacted the earnings of corporations involved in the energy complex, acting as a drag on S&P 500 earnings growth.

Investors entered 2015 expecting the Federal Reserve to begin raising short-term interest rates, a significant milestone after seven years of near-zero rates. The Federal Reserve took its first step to reduce the monetary life support put to work since the financial crisis, increasing the Fed Funds rate 0.25% in December, as noted above. This was the first time the Federal Reserve raised rates since 2006. The Fed noted an improving job market as the primary reason for the increase, despite the lingering problems with stagnant wages and low work force participation. The Federal Reserve will need to remain vigilant for signs that the long, but slow, economic recovery of the past six years remains on track as rates rise.

An increase in rates is always better for savers, but it also helps support a strong dollar as investors overseas buy U.S. investments to earn higher yields. It is a common belief that higher interest rates are bad for stocks, but a recent JP Morgan study provides contrary evidence. Going back to 1963, an increase in the benchmark ten-year Treasury interest rate up to roughly 5% was positively correlated with stock performance. Higher rates are often a signal of an improving economy. A better economy can lead to more consumer confidence and spending, boosting corporate earnings.

Many times, an increase in rates is a central bank policy response to inflation in the economy. Despite many years of low interest rates, we have experienced very low levels of inflation, stymied by poor wage growth and declines in oil prices. The Wall Street Journal reports that inflation has failed to hit the Fed's 2% target for over three years now, even with improving employment. Some of this has to do with the way the Fed measures inflation, using the core PCE index which excludes food and energy and tends to underweight housing costs, which have been moving higher. The Fed is hopeful that improving employment will persist, leading to upward pressure on wages, increasing inflation into a range that signals a healthier economy.

Unfortunately, few decisions can be executed without some negative consequences. An increase in rates in the U.S., even at a modest pace, is no exception. Higher rates increase costs for borrowers of all types, including sovereign borrowers that took on heavy dollar-denominated debts during the financial crisis to support local economies. Of particular concern are emerging economies. According to the IMF, emerging market borrowing doubled in the past five years to $4.5 trillion. Not only do emerging economies face the threat of capital flight as investors seek higher yields by owning U.S.-dollar investments, the debt becomes harder to service as dollars become more expensive relative to local currencies.

As we proceed in 2016, we continue to face many of the same issues that have been lingering since the end of the financial crisis. Your B|O|S team will help you navigate the uncertainty and formulate expectations for your financial future, tailoring your investments to meet your unique circumstances.

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Quarterly Review of Securities Markets: Total Return

Index	Market	Fourth Quarter	Year-to-Date as of 12/31/15
Standard & Poor's 500	Large Co. U.S. Stocks	7.04%	1.38%
Russell 1000 Value	Large Co. U.S. Value Stocks	5.64%	-3.83%
Russell 2000	Small Co. U.S. Stocks	3.59%	-4.41%
MSCI All-Country World ex US (ACWI)[1]	Foreign Stocks	3.24%	-5.66%
Barclays 1-5 Year Gov't/Credit	U.S. Shorter-Term Taxable Bonds	-0.57%	0.97%
Barclays Aggregate Bond	U.S. Taxable Bonds (Broad-based)	-0.57%	0.55%
Barclays 1-5 Year Muni Bond	U.S. Shorter-Term Tax-Exempt Bonds	0.08%	1.21%
JP Morgan Global Non-US Gov't Bonds	Foreign Bonds	0.60%	1.68%

Key Economic Indicators

- The latest U.S. GDP figures (third quarter) showed the economy growing at an annual rate of 2.0%. Improvements in both residential and non-residential investment were partially offset by higher than usual inventory growth.

- The U.S. Federal Reserve raised the Fed Funds rate target by one-quarter point in mid-December to 0.25%-0.50%. The Fed cited continuing improvements in the US employment situation and confidence that inflation will move towards the target rate over time.

- The latest US employment report showed stronger job growth than expected. Nonfarm payrolls jumped 292,000 in December. Despite the increase in payrolls, the Unemployment Rate remained steady at 5.0% as more people began to look for work.

- U.S. inflation remains low. The latest Consumer Price Index data (November) showed an annual inflation rate of 0.5%. The low inflation rate continues to be primarily driven by decreasing energy costs. Core CPI (CPI less food and energy) posted an annual increase of 2.0% through November.

- Commodity prices dropped during the fourth quarter, mostly due to declines in energy sector. The Bloomberg Commodity Index was down 10.52%. The price of crude oil dropped 18% to $37 per barrel. Gold (-4.8%, $1,061) and silver (-4.3%, $13.84) both moved lower during the quarter.

Key economic indicators compiled by Jeffrey Blanchard, CFA, Investment Analyst; jeffrey.blanchard@bosinvest.com

Data Sources: Morningstar; Econoday; Bloomberg.com

(1) Source: MSCI. Neither MSCI nor any other party involved in or related to compiling, computing or creating the MSCI data makes any express or implied warranties or representations with respect to such data (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties or originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of such data. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in or related to compiling, computing or creating the data have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages. No further distribution or dissemination of the MSCI data is permitted without MSCI's express written consent.

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