HOWLAND CAPITAL
Private Investment Advisors
APRIL 2014

STOCK INDICES

	Price % Chg. Quarter	Price % Chg. Last 12 Months
Dow Jones 30	-0.7%	12.9%
S&P 500	1.3%	19.3%
NASDAQ	0.5%	28.5%
MSCI EAFE	0.0%	14.4%

TREASURY YIELDS

	3/31/14	3/31/13
2 year Note	.44%	.25%
10 year Note	2.73%	1.87%
30 year Bond	3.56%	3.10%

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ECONOMIC & MARKET COMMENTARY

THE ECONOMY

Last quarter, we observed that a sustainable economic recovery was materializing in the U.S., and expressed our belief that future growth would be higher in the coming months. That proved to be correct, as the most recent data shows the U.S. economy grew at a revised annualized rate of 2.6% from October through December of last year. While there are some seasonal factors that influence this data, it is clear that both consumer spending and business investment have gathered speed in recent months, fueling the expansion. The positive trend is also confirmed by the employment data we are seeing, which shows that hiring is accelerating while the unemployment rate continues a downward trend toward 6.5% - the level at which the Federal Reserve initially indicated it would wind down the stimulus program. While there is nothing "magical" about any one of these individual statistics, when taken together they reinforce our belief that the U.S. economy will continue generating real growth of at least 2.5% in 2014.

While this forecasted pace of economic growth is consistent with the kind of "slow but steady" improvement seen in prior cycles, it is worth remembering that this recovery is anything but normal. The biggest outlier is unconventional monetary policy, as the traditional method of setting short-term interest rates has been taken to the extreme, with real returns (adjusted for inflation) below zero percent! The never-before-seen direct market purchase of hundreds of billions of government bonds over the past few years has also lowered long-term interest rates. The intent is to reduce the cost of borrowing for businesses and consumers, thus encouraging hiring and spending. It has thus far worked, at least in the short-run, as growth, unemployment, and inflation measures have returned to levels not observed since before the Great Recession of 2008. But the consequences of this policy have yet to fully play out; hence the market's skittish behavior as it hangs on the Federal Reserve's every nuanced word. The Bernanke, now Yellen, experiment

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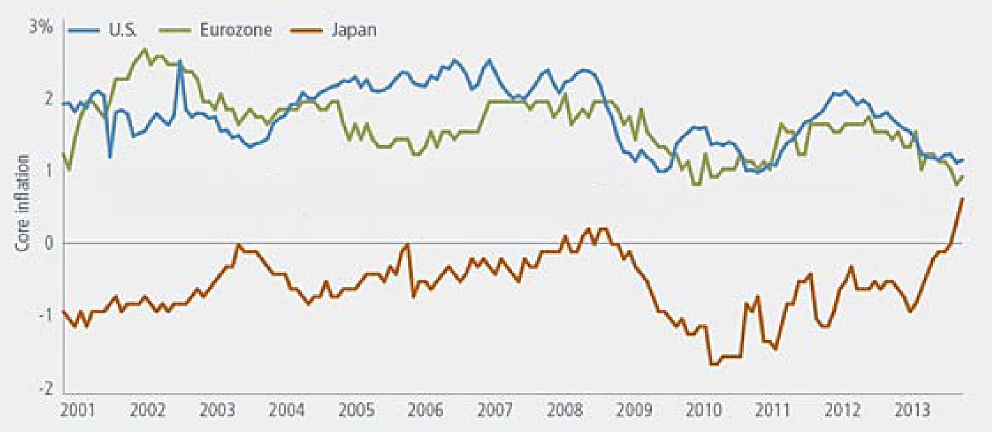
Contained Inflation Takes Pressure Off Central Banks



Source: Bloomberg. Data through 31 December 2013.

THE ECONOMY

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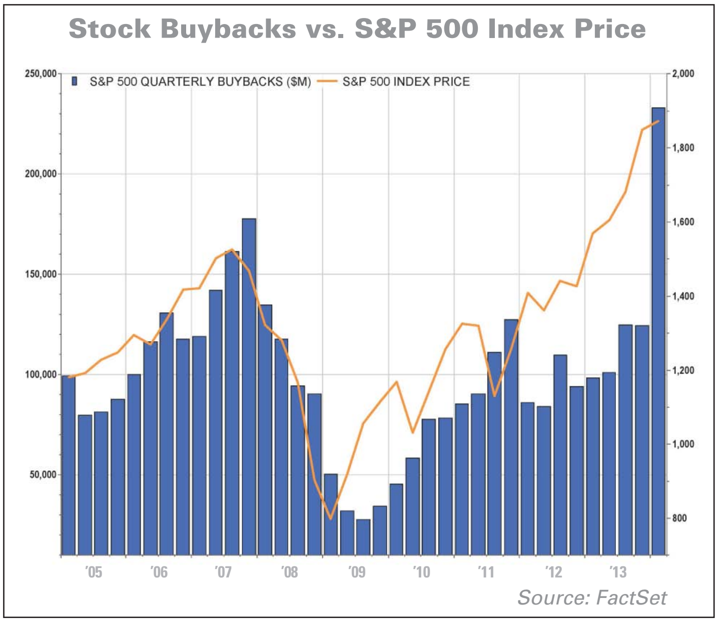
directly influences (in some cases overly inflates) the price of all asset classes in some manner and it is the reason that the word “bubble” has crept back into investors’ lexicon.

On the surface, this does not sound like a bad tradeoff, especially on the heels of a year during which U.S. equities advanced more than 30%. But the catch has to do with the true cost at which the Treasury prints money. Simply put, the cost is the interest rate that must be paid semi-annually, or the “carry” that investors receive, until the principal is repaid. Right now, the average cost of outstanding Federal debt is below 2%. But it is not hard to imagine a scenario in which investors demand a little more return – either because of higher perceived risk, or higher inflation which would reduce the real return. In fact, it was only seven years ago when the average coupon on outstanding Treasury debt was closer to 5%. It does not sound like much – but it would more than double the interest cost associated with the huge amount of outstanding debt that has been issued. Furthermore, it would likely lead to lower demand by large foreign purchasers of U.S. debt by export-driven nations who have been eager to purchase dollar-denominated bonds in order to keep their own currencies weak. As anyone who has invested on margin and received a “margin call” can attest, it works – until it doesn’t. While we do not foresee an immediate crisis in the bond market, one cannot help but wonder whether a rougher path awaits us.

STOCKS

After delivering an impressive 32% return in 2013, U.S. equities generated mixed results in the first quarter of 2014. Specifically, the total return of the cap-weighted S&P 500 advanced 1.8% while the dollar-weighted Dow Jones Industrial Average actually declined 0.15%. Positive economic growth discussed earlier, coupled with the consensus view that monetary policy will remain accommodative under new Fed Chair Janet Yellen, provided the backdrop. The Fed has begun to move closer to a “neutral” policy stance, as the risks for the economy and the labor market are about evenly balanced, and inflation remains in check. As a result, we believe that the current macroeconomic environment will continue to provide a tailwind to support stock prices for the remainder of the year. Although this will fade in time, there continues to be substantial investor appetite for income and growth that will support demand for domestic and international equities.



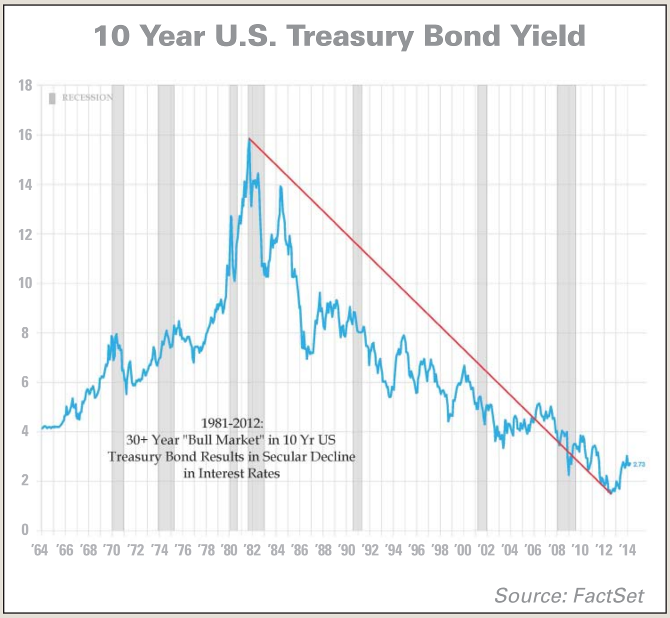
The stock market has also been supported by growth in dividends and share buybacks, which have collectively risen as a percentage of earnings over the past five years. Dividend growth in particular demonstrates a higher degree of confidence by managements in the cash generating abilities of their businesses. Share buybacks are another indication of strong underlying confidence in stock prices. However, the effectiveness (or yield) of stock buybacks fades as stock prices rise. The other reason we view buybacks with skepticism is that corporations seem to follow the pattern of retail investors: buying high and avoiding purchases when stock prices are low. As such, we continue to emphasize companies that grow their dividends regularly and consistently, not only to generate income, but as confirmation of enduring financial and long term competitive strength.

Consistent with this backdrop, the U.S equity allocation in many of our client portfolios is at the high end of the target range suggested by our models. For the time being, we are comfortable with this asset allocation as we believe the risk/reward profile remains favorable for stocks when compared to either bonds or cash. With stocks having advanced strongly over the past fifteen months, a pullback in stock prices representing a modest correction would not surprise us. This is one of the reasons that we recommend clients always maintain some liquidity in the form of outright cash or short-term bonds in their portfolios. The benefit is twofold –it allows us to meet short term demands for cash (taxes, tuition, monthly remittances, charitable and family gifts) without having to sell stocks, and also provides capital for investment opportunities.

In contrast, although we have maintained our allocation to International Equities, we remain below our target allocation. We have obtained our International Equity exposure several ways: via institutional shares of well-managed open-end mutual funds, exchange traded funds (ETFs) with a specific focus (e.g. emerging market consumer), and dollar-denominated American Depositary Receipts of companies domiciled overseas (e.g. Roche, Vodafone, Danone, etc.). This direct exposure to foreign companies is supplemented by many of the U.S. companies owned in client portfolios that have meaningful exposure to markets outside of the U.S. and we have selectively owned stocks that stand to benefit directly from exposure to certain geographies (e.g. Colgate, MercadoLibre, Yum! Brands). We believe the underlying growth and fundamentals of many of these international markets continue to improve and in many cases their valuations are well below the U.S. market and comparable U.S. companies. As a result, we have taken advantage of this weakness to add to our holdings, with the goal of bringing our international exposure closer to our targeted allocation over the remainder of the year.

FIXED INCOME

The Federal Reserve has begun to reduce the amount of government bonds it is purchasing every month, but these purchases have been targeted at intermediate and longer-term bonds, not short-term bonds. It is not surprising, therefore, that the yield on the benchmark 10 year US Treasury bond has risen above 2.5%. Even at this level, the 10 year bond yield is barely above long-term inflation expectations, which means that the *real* return (after subtracting for inflation) is virtually zero. A long-term view reminds us that the last thirty years have marked the longest "bull market" for bonds in history. Amid soaring inflation, cold-war budget deficits, and a severe recession, the 10 year Treasury bond yield peaked at 16% in 1981 and has since fallen to the lowest levels in history. So what is the implication for investors? We maintain that the best approach is to select high-quality bonds with a focus on maturities less than seven years on average. By definition, some income is forgone in order to avoid principal risk, but this approach allows for a steady stream of maturing bonds that can be re-invested at interest rates that are likely to be higher in coming years.



Source: FactSet

While we have referenced government bonds to illustrate the current interest rate environment, it is important to note that we do not favor these as an investment option. Instead, our purchases have focused on high quality corporate bonds where we have confidence in the ability and willingness of management to pay timely interest and principal due, and where investors can collect an attractive additional yield or "spread" above similar maturity government issues. The same is true for municipal bonds, where we have witnessed a marked improvement in the fiscal health of many state and local governments, but the black cloud over issuers such as Detroit and Puerto Rico have kept prices in check for the entire market. Finally, we are focused on bonds with an attractive structure – such as those that offer coupons that may increase, or "step-up" over time – thereby mitigating the price impact of higher interest rates which normally would cause bond prices to fall.

SOCIAL SECURITY

When planning for retirement, there are many factors that influence the decisions and choices one has to make regarding current and expected income. One important, albeit confusing source of income is Social Security. It is not surprising to us that surveys indicate that 7 in 10 individuals nearing retirement would be interested in receiving advice on how and when to claim benefits. Since addressing this topic last year, we have come to find that there is a knowledge gap between what many think they know about claiming Social Security benefits and the *actual rules* that govern the Social Security program. This gap is significant enough that the average retiree often receives $100,000 less than what they could have received over their retirement had they been better informed. That number can jump to $250,000 for a married couple who choose to start receiving benefits as soon as possible, rather than fully exploring other options.

Timing is everything with Social Security too! For example, if your birth date is between 1943 and 1954, you retire at 62 (which is before the full retirement age or "FRA" as it is known) and start claiming benefits, the monthly payout would be 75% of the "primary insurance amount" due to you. At an FRA of 66, the monthly benefit is 100%. But, if you delay receiving benefits until age 70, the retirement credits accrue and the monthly benefit is 132%. As can be seen, it may make sense to dip into your savings or keep working for a few years to let the Social Security benefits accrue, especially if you are a high earner. This is the case because benefits are based on an individual's average indexed monthly earnings, which is defined as the average of the highest 35 years of an individual's earnings (indexed for economy wide wage growth.)

Additionally, there is an unusual claiming strategy for couples in which both are earners – a common occurrence with the baby-boom generation. Assume both are 66 years old. The wife is eligible to receive $2,000 per month, and the husband is eligible to receive $1500 per month. If the wife files and suspends her benefits, her husband can claim spousal benefits of $1,000 per month while she earns 8% per year in delayed credits for retirement. The husband also files and suspends for now, receives $1,000 until he switches to his $1,500 monthly benefit at 70, all the while earning 8% in delayed credits. Clearly having both earn the 8% per year in delayed credits will increase the amount they start to receive at age 70. There are various permutations on this strategy based on the unique circumstances for each couple, but suffice it to say that many retirees are not maximizing their retirement benefits because they have not done a comprehensive analysis to determine which approach is best for them.

Studies have been done to determine the differences among the many claiming strategies. Using actual interest rates and mortality improvements, one finds three interesting results:

- Single men born in 1951 maximize their benefits by claiming at age 69, and receive a gain of 12.6% from the delay. Single women born the same year maximize their benefits by claiming at 70, and receive a gain of 17.8% from the delay.
- In general terms, a two-earner couple with a 2 year age difference receives a gain of 21.5% by using one of the "delay strategies".
- A couple with a 2 year age difference with a single earner receives a gain of 19.8% by using a delay strategy.

It is confusing when there are options like "file and suspend," "claim some now; claim more later," "combined strategies," and "no can do over" – but we are happy to help you analyze the various options.

Remember, your personal savings are an essential component to this choice. Social Security is rarely enough to meet your full retirement needs, and having enough savings to avail yourself of the opportunity to delay until 70 will be a welcome outcome if it is the right choice for you.

PRIVACY NOTICE In the ordinary course of our business, we collect nonpublic personal information about you from the information we receive from you on applications and other forms and from your transactions with us. Any nonpublic personal information about you is not disclosed to non-affiliated third parties, except in compliance with or as required by law. In connection with servicing your account, your information may be shared with certain non-affiliated service providers, such as transfer agents, custodians or other service companies. In order to service your account and effect your transactions, it may be necessary for us to disclose all of the information that we collect, as described above.

Access to your nonpublic personal information is restricted to employees who need to know that information to provide products or services to you, which may include all of our employees, each of whom is provided with a copy of this privacy policy that he or she must read, sign and agree to follow. In compliance with federal standards, we maintain the security of your nonpublic personal information through physical, electronic, and procedural safeguards.

The policies and practices described above apply to all accounts at Howland Capital Management and we will adhere to them for both current and former customers.