WELLESLEY INVESTMENT PARTNERS
WEALTH MANAGEMENT
A SUBSIDIARY OF WELLESLEY BANK

Fourth Quarter 2016

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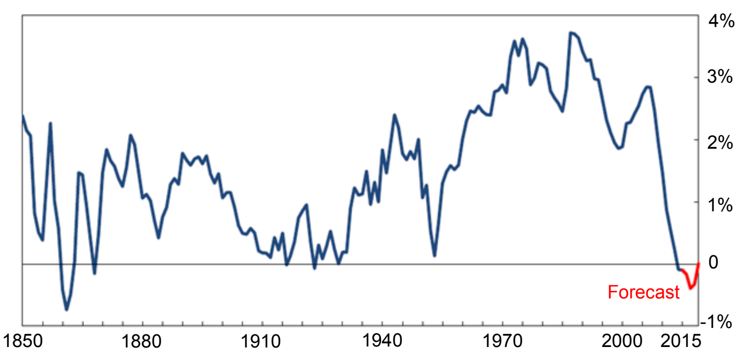
2016 — A Year of Surprises

British Prime Minister Theresa May (right) shunned at recent EU meeting. (Source: BBC)

Among the surprises of 2016, perhaps one of the most shocking – and most telling – was the British vote to leave the European Union (EU). It fit the recent trend of voters preferring nationalism over globalism. While global trade has broadly helped drive economic growth in recent decades, after-inflation wages for average Brits has fallen. Mark Carney, Governor of the Bank of England, recently gave a speech where he noted the "first lost decade since the 1860's" as after-inflation wages have declined in the wake of the global financial crisis.

British After Inflation Wage Growth - 10 Yr Moving Avg



Source: "The Spectre of Monetarism" by Mark Carney (Bank of England), December 5, 2016

Cueing the old Wendy's slogan ("Where's the Beef?"), voters are asking "Where's the Growth?", especially when it comes to their take-home pay. They have signaled a willingness to try something new.

Performance of Notable Indices[a]	Q4 2016	YTD (1/1/16 – 12/31/16)
S&P 500 Index	3.8%	12.0%
U.S. Midcap Equities	7.4%	20.7%
U.S. Small Cap Equities	8.8%	21.3%
International Developed Market Equities	-0.6%	1.6%
Emerging Market Equities	-4.3%	11.3%
U.S. Core Bonds	-3.0%	2.6%
Global Bonds	-6.6%	2.2%
Gold, $/troy oz	-12.8%	8.1%

Total return indices unless otherwise stated

Global stock markets have adjusted. The shock of the Brexit vote lasted about three days in late June. In the wake of the Trump victory, the Market sold off, and then recovered, in about three hours. And the impact of Italy's vote to unseat its Prime Minister (an EU supporter) was absorbed by the Market in about three minutes. Stock markets have looked past these events and have broadly rallied on improved earnings and brighter prospects.

Global bond markets, however, have been jolted with November delivering its worst month in over 30 years[a] as interest rates ratcheted higher on the prospect of more government infrastructure spending and less central bank intervention. The Federal Reserve raised its benchmark rate by 0.25% in December and signaled an expectation of three similar hikes in 2017[b]. The Market has priced in much of this expected Fed activity as it generally agrees the economy is strong enough to warrant modestly higher interest rates.

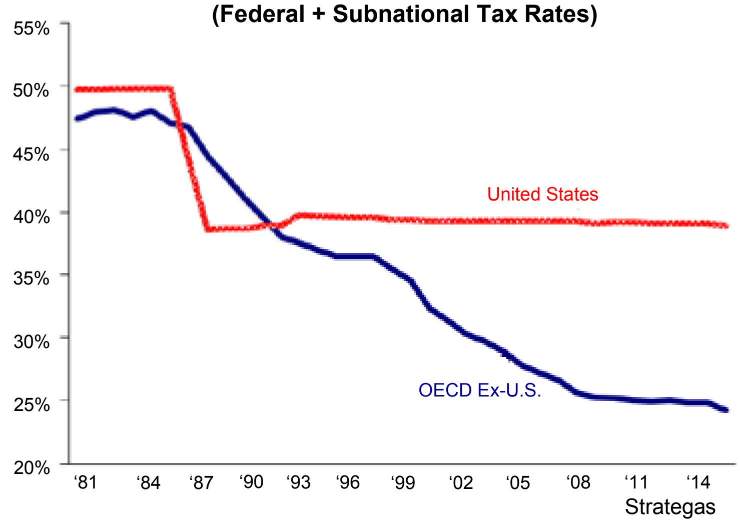
The net effect for many investors holding a mix of stocks and bonds was a fairly muted return in the fourth quarter with bond losses offsetting stock gains. We have favored shorter maturity corporate bonds over longer maturity sovereign bonds and, on balance, this positioning helped during the quarter as interest rates increased. While we do not see interest rates heading meaningfully higher, we do feel our current positioning continues to be appropriate.

a. Bloomberg
b. Federal Reserve Bank of San Francisco President John Williams

Since the bottom in 2009, stock markets have risen as corporate earnings have recovered and cash flows backing equity valuations have appeared attractive when compared to the meager rates offered by bonds. It has been described as an interest rate driven bull market. Recent stock gains in the face of higher interest rates suggest a shift to an earnings driven market. One driver is the expectation that corporate tax rates in the U.S. will be cut.

Thomson Reuters predicts that every 1% decline in the corporate tax rate generates an additional $1.31 in earnings for the S&P 500. You can see in the chart to the right that the U.S. has increasingly fallen behind the global trend of lower corporate tax rates. The Market has factored in some tax relief, with smaller, more domestically-focused firms benefitting the most[c].

Statistory Corporate Tax Rates
(Federal + Subnational Tax Rates)



The range of outcomes in 2017 seems wider than normal. If percolating issues in China and Europe remain subdued and business friendly initiatives in the U.S. are actually enacted, it seems likely that stocks have the potential to advance at a double digit rate. However, if political gridlock ensues in Washington, China slows unexpectedly and/or elections in Europe again bring into doubt the staying power of the EU, then it seems reasonable to expect a market decline. That said, current economic conditions do not suggest a recession during 2017 so our expectation is that a decline would be relatively shallow.

In our Global Asset Allocation strategies, we have been "Neutral" to our target allocations for the better part of 2016 as we viewed risks as balanced. We have been rewarded for overweighting U.S. stocks relative to non-U.S. stocks – our preference for mid-cap stocks helped while our underweight to small-cap stocks hindered returns. Longer term we still believe stocks will outperform bonds and are open to selling bonds in favor of stocks when the opportunity presents itself.

We have two Dividend Growth strategies, one of which screens for companies in the top half of its industry for scores on its Environmental, Social and Governance practices. While both strategies have approximately a 3% dividend yield, we favor owning companies which we believe have the ability to grow their dividends versus companies with a higher yield but with less capacity to increase those payments.

Our focus continues to be on thoughtfully building your wealth over the long term in a way in which you can understand and feel comfortable. The beginning of a year is always a good time to reassess and we look forward to talking to you as the year unfolds.

Here's to a healthy and prosperous 2017 for you and yours.

Regards,

Richard Sipley, CFA
Wellesley Investment Partners

c. Bloomberg

NOTES AND DISCLOSURES

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8. Notable indices shown for illustrative purposes include the S&P 500 Total Return Index, the S&P Midcap 400 Total Return Index (U.S. Midcap Equities), the Russell 2000 Total Return Index (U.S. Smallcap Equities), the MSCI EAFE Total Return Index (International Developed Market Equities), the MSCI Emerging Markets Total Return Index (Emerging Market Equities), the Barclays U.S. Aggregate Total Return Bond Index (U.S. Core Bonds), Gold spot price/troy ounce in U.S. dollars, and the JP Morgan Global Aggregate Total Return Bond Index (International Core Bonds). Data source: Bloomberg.
9. This report is for the quarter ending December 31, 2016.