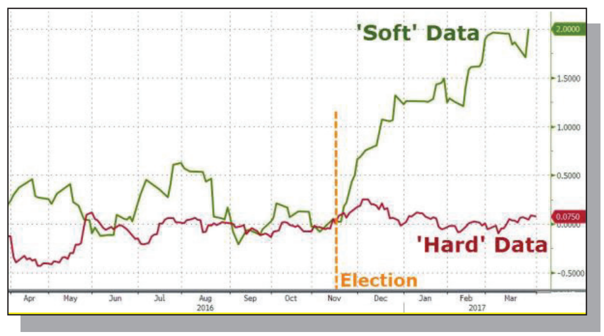
Hemenway Trust Company LLC

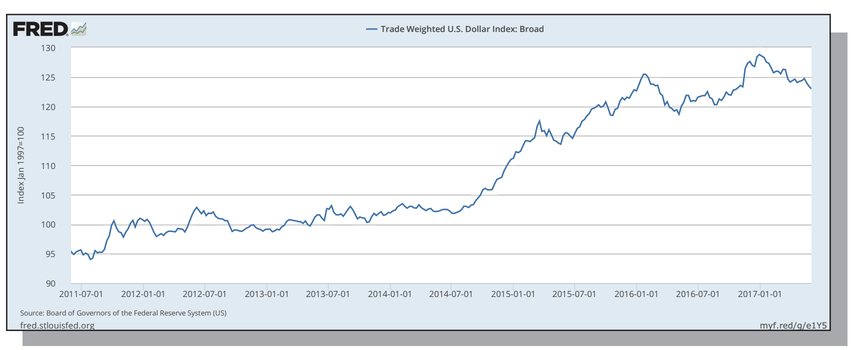
Beating Expectations

June 2017

Equity and bond markets are up broadly year to date, and, for the first time since the recession, there has been growth in all major economies worldwide. We have written about the strength and resilience of the US economy for quite some time, but we are now seeing positive economic data and sentiment from Europe and stability in China's market (despite increasing controls on its debt burden). After the election, we saw a surge in US consumer and business sentiment data ("soft data"), but many worry it has not been followed by a similar rise in real economic activity ("hard data"). This was confirmed again with the Q1 estimate of US GDP growing at only +0.7% (revised to 1.2%) year-over-year. While this data was surprising, as equity investors, we have been more focused on the quarterly data issued by companies… and in that data, there is much less to question. US companies in the S&P 500 (excluding energy, which saw earnings growth of 600%) are on track to see 11% growth year-over-year, with 70% of companies raising their financial forecasts. While we do not expect economic growth to move up in a straight line, we do believe we are in a growing economy and that a portfolio of prudently selected equites will provide the best opportunity for income and capital appreciation over the next three to five years, as well as a measure of stability.

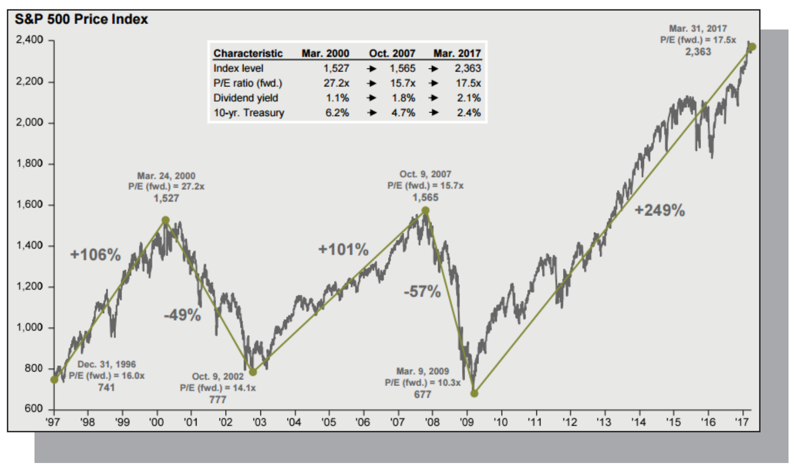


Over the past 10 years, US stocks, as represented by the S&P 500, are up 205% cumulatively, in contrast with international stocks (MSCI EAFE), which are up 10%. Due to this outperformance, we have been asked whether portfolios should be even more highly concentrated on the domestic market. We think not – our focus on market-leading businesses generally leads to companies with a wide geographical span; in fact, we estimate that the companies in our portfolio generate over half of their sales outside the US. We are agnostic on where a company is located, presuming a stable legal system is in place which protects both property and intellectual property rights, and understand currency can create additional volatility to earnings and stock price. Since 2012, we've seen the US dollar appreciate almost 30% on a trade



weighted basis. This has been a drag on sales and earnings for US companies selling into overseas markets and reduces the US dollar value of non-US companies. We do not expect the same drag for the next five years and, consequently, continue to search for non-US stocks selling essential goods and services that are trading at attractive valuations. We are also mindful that today's currency headwinds can turn into tomorrow's currency tailwinds.

It has been eight years since the Great Recession, and US equity markets are up over 250%. We review many new companies with healthy growth prospects, run by talented managers, however their stocks trade at valuations we consider too high for comfort. Fortunately, not all stocks have moved up in tandem since 2009. Recently, healthcare stocks, which we have long favored, have underperformed due to pricing pressure and uncertainty around the future of the Affordable Care Act. Still, we are attracted to the sector as the global middle class grows and ages, and we have spent a good deal of time analyzing existing and new positions. Many of our core holdings in the sector are companies that are developing new drugs and therapies to treat (or even cure) debilitating diseases and are helping to drive down the cost of medicine over the long-term. While we expect there will be more transparency on pricing, new drugs will continue to have high prices to reward companies that spend years, and billions of dollars, to develop these drugs and therapies.



http://www.phrma.org/press-release/new-first-of-its-kind-study-shows-growing-share-of-medicine-list-prices-going-to-rebates-and-supply-chain

In volatile times, we understand it may be difficult to keep a long-term perspective, and the idea of sitting in cash may seem like a prudent investment strategy. However, while we have been reducing some positions, we continue to find investments with strong growth prospects trading at reasonable valuations. We would be happy to review your portfolio and walk through our investment thesis for all positions.