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From: The Portfolio Management Team

Performance Review

The MSCI EAFE returned 1.6% during the second quarter. In local currency terms, the index declined -0.8%, but a weakening US Dollar added 2.4% to US investors' returns. The US Dollar declined against the Euro and Yen and fell by nearly 9% relative to the Swiss Franc, which benefited from its "safe haven" status. Europe (+2.4%) outperformed the Pacific region (0.0%), which was pressured by concerns of a Chinese slowdown. The emerging markets (-0.7%) felt these concerns more acutely.

It was a volatile quarter, as strong corporate earnings results gave way to concerns over European sovereign debt issues, weakening economic indicators in the developed economies, and both inflationary pressures and monetary tightening in the emerging markets. Greece approved austerity measures in an effort to stave off default. China continued its tight monetary policy to dampen inflation in hopes of a soft landing. Commodity prices declined from the first quarter, but remained elevated.

Our international portfolios rose in value, but less than our benchmark, the MSCI EAFE. Regionally, our investments in emerging markets and in the Asia-Pacific ex Japan were the main detractors, while our stock selection in the U.K. helped. Stock selection in the Consumer Discretionary and Technology sectors detracted from relative performance, while stock selection in the Materials sector contributed to our relative returns.

Investment Outlook

Expectations for regional and global economic growth remain in flux. On the one hand, the developed European countries and Japan face structural issues that continue to retard the foundations for growth. While not true for every country, as a whole, the excessive leverage in these economies underpins expectations for a slower and more fragile recovery. On the other hand, the emerging markets of Asia and Latin America face pressures associated with strong growth. Inflationary strains are building as wages rise and asset prices increase. The interplay between these regions, one anemic and the other overheated, continues to produce financial market volatility.

Recent economic trends have sent mixed signals regarding the health of the global recovery. We believe that the softer industrial and consumption numbers reflect short-term dislocations from the external shocks of political unrest and the Japanese disaster, rather than the beginnings of a new cyclical downturn. In our view, international equities have a choppy but positive outlook, and valuations look attractive relative to history.

Market Index Returns

	2 nd Qtr. 2011	YTD 2011	Year 2010
MSCI EAFE	1.6%	5.0%	7.8%
MSCI Europe ex UK	2.8%	10.8%	1.6%
MSCI United Kingdom	1.7%	5.6%	8.8%
MSCI Japan	0.2%	-4.8%	15.4%
MSCI Pacific ex Japan	0.2%	2.5%	16.9%
MSCI Emerging Markets	-1.1%	0.9%	18.9%

Europe

Most Northern European countries have strong economic outlooks. For example in Sweden, the largest Nordic country, GDP growth is forecast to be 4.4% this year and the unemployment rate has fallen consistently over the past year. Inflation of 3.3% is above its target, which has prompted Sweden's central bank, Riksbank, to raise interest rates seven times in the past year.

At the same time, European policymakers are fighting to contain the sovereign debt crisis that is threatening much of Southern Europe. Although Greece dominated headlines for much of June, falling bond and bank stock prices in Italy in early July are of far greater concern. Italy is the third largest economy in the monetary union, accounting for about 17% of total output. Italian government debt is €1.8 trillion, over five times the size of Greek debt in absolute terms. In contrast to Greece, Italy's primary fiscal budget has been near balance over the last three years, and the country did not have a property bubble like Spain and Ireland. Italy's problems reflect its subpar growth, low labor productivity, and its high government debt burden, at 120% of GDP. Although we expect Italian bonds to stabilize, we are mindful of the power of market contagion.

Bailout plans and austerity packages may prevent immediate default, but they are unlikely to command lasting confidence in the global bond market, and they are likely to lead to deteriorating economic health. In our view, Europe is unlikely to abandon the Eurozone, but rather will continue its approach toward greater unity. Investors are looking for an immediate, comprehensive solution, and may push markets to the brink of collapse to pressure politicians to take action. A relatively positive result of the crisis would be if market pressures enable passage of otherwise politically unpalatable reforms. Reforms that help restructure labor markets by easing employment constraints could boost long-term growth potential.



Relative to the MSCI EAFE, we are underweight the Eurozone and the UK, with an overweight in Swiss stocks. In Europe, we are underweight the Financial and Consumer Discretionary sectors and overweight Energy and Technology, reflecting our preference for firms that participate in global industrial growth over those exposed to European credit and consumption.

Japan

The Japanese economy appears to be on the road to recovery from the Tohoku earthquake, yet repercussions are likely to reverberate for some time. Industrial production has rebounded from March and April even though it is still 9% below February’s levels. In the key auto sector, production is still more than 30% below pre-quake figures. Although the Japanese Diet passed a reconstruction bill, it has not delivered reforms that some speculated could be a product of crisis management.

Germany’s response to the nuclear disaster has been more dramatic than the reaction in Japan. The Green party registered a major electoral victory in a key state and the ruling coalition reversed its position and supported the decommissioning of existing nuclear power plants in the country. In Japan, 64% of the country’s nuclear plants are off line for maintenance, and those that have been scheduled to come back on have been delayed. The future of power in Japan is up for debate, but with 24% of generation from nuclear plants it will be difficult for the country to manage any major changes in the near term. We expect a global shift away from nuclear energy will require substantial investment in natural gas as well as renewable power infrastructure. We are moderately underweight Japan and favor export-oriented companies with high-quality products.

Asia Pacific ex Japan and Emerging Markets

Emerging markets’ robust demand for industrial and consumer products played a role in stopping the precipitous decline of the 2008 recession and supporting global corporate profits. This year, concerns about overheating in much of Asia and Latin America have pressured emerging market stocks as well as global markets in general. Inflation has recently registered above 10% in countries ranging from Argentina to Vietnam. In Brazil, annual loan growth has averaged 22% over the past five years, which is more than twice as fast as economic growth. Although financial services are relatively underpenetrated in emerging markets, excessive credit expansion has been a factor in past crises in developing and developed countries.

Policymakers have responded with interest rate hikes and regulatory changes to cool growth. China’s most recent interest rate hike pushed its lending rate to 6.56%, slightly above its most recent inflation reading. This action adds China to the short list of countries with positive real interest rates. In our view, emerging market growth is a sustainable secular trend, but we are carefully monitoring the risks of a cyclical deceleration, particularly given relatively high expectations inherent in some stocks’ valuations. We remain overweight in the combination of the developed Asia Pacific ex Japan and the Emerging Markets, with an emphasis on investments in the Financials and Consumer Discretionary sectors.

Portfolio Activity

During the quarter, we purchased British industrial company Spirax-Sarco Engineering. The company sells steam-based heat exchange systems and peristaltic pumps. Industrial customers can recoup their investment in these products over a few years via energy and water cost savings. Emerging markets account for 40% of Spirax’s revenues and recurring maintenance is a key contributor to sales, providing avenues both for growth and stability. We believe Spirax can maintain high single digit organic revenue growth, and that its valuation is attractive. We also added Worley Parsons, an engineering and construction firm focused on the energy sector. Proprietary knowledge and expertise and a strong global end market make this a good business, in our view. We also like Worley’s exposure to sustainable infrastructure development, including solar, thermal, and water desalination plants.

Company Spotlight

Vossloh AG

Description

Vossloh AG is a rail equipment supplier with leading positions in fastening systems, switches, diesel locomotives for freight, and electrical systems for trams. Vossloh’s business is focused in Western Europe (67%), with a growing presence in Asia (18%) and other emerging economies (13%).

Investment Thesis

In our view, railroad equipment and infrastructure needs are likely to grow over the long term given the demands of urbanization, global infrastructure development, and rising personal transportation costs. The company has a strong presence in the stable European market and has had some success participating in the construction of the Chinese rail network, the largest in the world. We believe Vossloh’s competitive position is supported by its strong balance sheet. Valuation looks attractive to us given positive long-term dynamics.

ESG Profile

Vossloh provides infrastructure for railroads, which use less energy and produce less emissions than motor vehicle transport. Vossloh has done leading work in optimizing the environmental features of rail and bus transportation. The Firm’s environmentally innovative products include its new, lighter-weight diesel-electric EURO 4000 locomotive, which consumes less energy, as well as zero-emissions propulsion technologies for trolley buses and a system for recycling ballasts and rails. All large Vossloh locations are certified to the ISO 14001 environmental management standard.

Company examples are drawn from model portfolios using Boston Common’s comprehensive social screens. Holdings may vary by portfolio due to customized account features. The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that the securities discussed herein will remain in the account’s portfolio at the time you receive this report or that securities sold have not been repurchased. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable. As with any investment, there is a risk of profit or loss.