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From: The Portfolio Management Team

Performance Review

The MSCI EAFE Index gained 3.4% in the first quarter as the market looked past geopolitical turmoil. Japan’s earthquake, tsunami, and nuclear crisis depressed the Pacific region (-2.0%), which lagged Europe (+6.5%). In local currency terms, the EAFE gained 1.0%, but a weakening Dollar added another 2.4% to U.S. investors’ returns. The Euro and Pound appreciated by 5.8% and 2.4% respectively against the Dollar, as monetary policy expectations for Europe grew tighter relative to accommodative U.S. policy. The Yen (-1.4%) weakened versus the Dollar following collective central bank intervention.

Geopolitical turmoil weighed on the markets for most of the quarter. In Japan, the disaster caused severe bottlenecks and systemic shortages of electricity, which continue to hold back industrial production. The crisis at the Fukushima nuclear power facility raised worldwide questions about the wisdom of nuclear power investments. The Arab spring brought historic shifts to the Middle East and North Africa. Popular protests toppled autocratic regimes in Tunisia and Egypt, while NATO air strikes in Libya supported rebels in a civil war. Commodity markets were most directly impacted by the Arab uprisings. Crude oil prices reached two-and-a-half-year highs, while gold and silver prices hit all-time highs.

Our international portfolios performed in line with our benchmark, the MSCI EAFE. Stock selection in the Technology and Utilities sectors contributed to our relative performance. From a regional perspective, our relatively low allocation to Japan and our export-oriented holdings in Japan helped our relative performance. Stock selection in the Financials and Healthcare sectors and in Europe detracted from relative performance.

Investment Outlook

Macroeconomic challenges continue to cause market volatility. Rising commodity prices pose an inflationary threat. We expect monetary policy in emerging and developed countries to grow more restrictive. Europe must balance economic strength in core countries against structural weakness in its periphery. And Japan’s rebuilding needs highlight its grim fiscal position.

Despite these headwinds, the global economic expansion appears to be gaining momentum. The International Monetary Fund is forecasting 2011 and 2012 global growth of 4.5% which is slightly below the peak during the 2004 to 2007 boom, but greater than any

Market Index Returns

	1 <sup>st</sup> Qtr. 2011	Year 2010	Year 2009
MSCI EAFE	3.4%	7.8%	31.8%
MSCI Europe ex. UK	7.8%	1.6%	32.6%
MSCI United Kingdom	3.8%	8.8%	43.3%
MSCI Japan	-4.9%	15.4%	6.3%
MSCI Pacific ex. Japan	2.8%	16.9%	72.8%
MSCI Emerging Markets	2.0%	18.9%	78.5%

individual year from 1980 to 2004. On balance, we are cautiously optimistic in our long-term expectations for international equities.

Europe

One day after Portugal became the third of the 17 Eurozone member states to request a bail out, the European Central Bank (ECB) raised interest rates, reflecting the stark contrast in economic prospects between Europe’s core and peripheral countries. In Germany, Europe’s largest economy, growth prospects look bright. Emerging markets’ robust demand for German industrial goods has given the country a boost. Germany’s recovery stands out in that unemployment has fallen to a 20 year low of 7.4%, while most other developed markets have stubbornly sluggish job markets. Inflation in the Eurozone recently rose to 2.6%, above the ECB’s target of 2%, on the back of strong commodity prices and rebounding economic performance in the core Northern European countries. Given these developments, the ECB elected to tighten monetary policy.

In contrast, Portugal’s economy, which is 1/15th the size of the German economy, may be heading back into recession. The economy has chronically underperformed Europe, apparently due to poor productivity, double-digit trade deficits, and persistently high fiscal deficits. From 2001 to 2007, Portugal’s average annual gross domestic product (GDP) increase was 1.1%, or about 40% lower than the Eurozone’s overall growth. The natural result of high deficits and low growth is a high debt load, which now stands at 83% of GDP. The prescribed cure for Portugal, like Greece, Ireland, and Spain, is likely to be some combination of falling wages, less government services, higher taxes, and depressed domestic demand. If these ingredients fail to produce economic growth, these peripheral countries’ debt burdens may rise relative to GDP and some of these economies may ultimately be insolvent and require debt restructuring.



Despite the potential for serious and sustained negative outcomes, European policymakers have taken a measured approach in responding to the sovereign debt crisis. A recent European summit produced an ostensibly “Grand Bargain” that set rules for a permanent bailout fund, increased the lending capacity of the existing fund, and presented an agenda for long-term fiscal consolidation and improved competitiveness called “The Euro Plus Pact.” Despite the ambitious names, it is difficult to see how the reforms will meaningfully change Eurozone members’ prospects. Instead, we view the outcome as another incremental step that fails to resolve peripheral countries’ structural problems. We expect Europe to continue on an uneven growth path. In our portfolios, we are underweight the Eurozone and U.K. relative to the MSCI EAFE but overweight Switzerland. We favor companies based in core countries that operate in global cyclical sectors.

**Japan**

The human and capital costs of the Tohoku earthquake have not yet been counted, but the damage looks substantial. The Japanese economy will at least be slowed by the loss of production, rolling power shortages, and disrupted supply chains. Reconstruction efforts should eventually help recover the lost output in GDP terms, but there may be long-term repercussions for global energy markets. We have long avoided stocks in the nuclear power industry, because we have been concerned about the environmental, social, and governance (ESG) risks associated with the disposal of highly radioactive materials. In the power sector, we favor renewable energy producers, natural gas companies, and enablers of energy efficiency.

In the aftermath of the earthquake, the Japanese currency strengthened to a 20-year high of 76 Yen per Dollar. Investors anticipated a repeat of the events after the 1995 Kobe earthquake, when Japanese companies and citizens sold foreign currency and bought Yen to pay for damages, leading the currency to appreciate by 20% relative to the Dollar. To avoid a recurrence of the past, the Bank of Japan (BOJ) convinced the Group of Seven (G7) countries to collectively sell the Yen to depreciate the currency and prevent the headwinds from higher foreign currency prices for exporters’ goods. The BOJ also responded to the emergency by doubling its asset purchases, also known as quantitative easing, as a way to stimulate the markets and the economy.

The Japanese equity market is currently about one quarter of its peak 1989 level and one half of its 2000 level. Japanese stocks look inexpensive, as the market trades at about 12 times next twelve months earnings and 1.2 times book value, which are almost 60% and 40% below long-term averages, respectively. However, an aging and shrinking population, muted real economic growth, and persistent price declines limit Japan’s appeal to investors. In addition, Japan’s already weak fiscal picture is likely to be exacerbated by government spending to rebuild in the wake of the earthquake. Over the last 20 years, Japanese fiscal deficits have averaged about 5% of GDP per year and government debt has increased from 70% to 220% of GDP. In our opinion, the challenging domestic environment requires careful analysis of individual Japanese stocks.

We have narrowed our underweight in Japan and are looking to buy companies with fundamental outlooks justifying potentially higher valuations.

**Portfolio Activity**

During the quarter we purchased Sampo Group, a Nordic insurance and banking company that has an excellent record of actively managing its investment and operating assets. Sampo appears positioned to benefit from macroeconomic strength in the Nordic region. We also added a Belgian company, Umicore, which is the largest recycler of precious metals in the world. The company’s historic strength in material science could help in its development of new clean tech businesses, including lithium-ion battery recycling.

**Company Spotlight**

**Kubota Corporation**

**Description**  
Based in Japan, Kubota manufactures farm and industrial machinery (66% of sales), including tractors and combines. The company also produces water and environmental systems (24% of sales), such as pipes, membranes, and water treatment plants. Remaining sales come from a variety of industrial products. Geographically, Kubota generates revenue in Japan (59%), North America (19%), Asia ex. Japan (15%), and Europe (7%).

**Investment Thesis**  
Kubota should benefit from rising global demand for agricultural commodities, as higher farm income leads to more investment in farm equipment. We think mechanization of Asian farming is a secular trend that should also drive demand for Kubota’s products. The company already has significant share of the Thai and Chinese markets and is rapidly growing its business in Vietnam and India. Kubota also offers the opportunity to participate in the long-term development of water infrastructure. Trading at 9 times EBITDA, valuation appears reasonable given our positive fundamental outlook for Kubota.

**ESG Profile**  
Kubota has an industry-leading environmental management system and is innovating products aimed at growing demand for natural resource conservation. For example, Kubota’s wastewater treatment tanks allow hospitals and other facilities in sparsely populated areas to efficiently treat, recycle, and reuse water. Kubota sends its sustainability commitments down the supply chain through procurement standards for suppliers, covering energy consumption reduction, simplification of packaging, and adoption of controls to prevent air and water pollution.

*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.*