Dear Client,

The first quarter saw a resurgence in investor confidence as the S&P 500 hit an all-time high on the last trading day of the quarter. It’s been five painful years since the financial crisis hit in 2008 and spilled over into 2009, wiping out more than half of the S&P’s value and creating a “Wall” of mistrust between the investing public and “Wall Street.” Interestingly, a lot of the issues that caused angst among investors over that time frame remain a threat today but investors have accepted the risk as manageable or become desensitized to the repeated negative outcomes played up by the media. Still, the issues at hand, such as weak U.S. job growth, the euro-zone debt crisis, fallout from the federal spending cuts (Sequester) and a weaker-than-anticipated earnings season are real threats that could undermine current investor optimism and derail the recent trajectory of the stock market. However, the Federal Reserve, along with other central banks around the world are not taking these threats lightly, which explains the magnitude of their accommodative monetary policies and has resulted in driving investors’ optimism and risk-taking in the equity markets.
Market Recap

The current investing environment has rewarded those investors who followed the old adage “don’t fight the Fed.” That has meant loading up on stocks and lower rated corporate debt as the Fed increased the money supply and pushed interest rates to historically low levels and in the process reduced the attractiveness of “safer” investments such as U.S. Treasuries. Moreover, the last six years has witnessed central banks creating over $11.6 trillion in liquidity through more than 500 interest rate cuts forming a foundation for higher equity prices. As a result, those countries with liberal monetary policies such as the U.S., England, and Switzerland had the largest quarterly equity gains of 10%, 8.7% and 14.5%, respectively, in the first quarter. Recently, the Bank of Japan has joined the Fed, the Bank of England, and the Swiss National Bank in opening their monetary spigot, sparking a rally of over 27% in the Nikkei Stock Average. A broader view of the developed international marketplace saw modest returns of 5%, as measured by the MSCI EAFE, while the emerging markets lost its momentum, with a -1.62% return, as near-term concerns over China weighed on performance.

The United States seems to be in better shape than the rest of the global market participants because of the quick and aggressive action taken on behalf of the Fed when the financial crisis began. The consequence of their actions allowed corporations to take advantage of the low borrowing rates in order to restructure their balance sheets. The end result was an increase in free cash flow and profitability. The earnings growth exceeded 6.7% this quarter, while top-line revenue growth trailed with a 3.7% rate of growth. Although corporations are still sitting on well over one trillion in cash, some of the money has been put to work
in the form of higher dividends, stock buy-backs and acquisitions, which is all positive for higher equity returns. While the S&P hit an all-time high, Mid Cap stocks took top honors this quarter with a return of 13.455, while Small Caps took a close second, with a return of 12.39%.

Eventually, investors will hit a fork in the road. At some point the Fed or other central banks will take their foot off the monetary pedal and economies will have to stand on their own without the artificial support of their central banks. However, the Fed Reserve has been very clear in trying to communicate its goal of 6.5% unemployment with a 2.5% inflation target before they reduce their monthly purchases of $85 billion in Treasury and Mortgage-backed securities. As the Fed’s purchases continue to weigh on yields, investors have swapped out of high quality bonds such as Treasuries and Corporate Bonds for the higher yields of below-investment-grade bonds. Consequently, the return for the overall bond market as measured by the Barclays Aggregate Index was -.12%, while the high yield index was up 2.9% for the quarter.
Market Recap (cont.)

On the household side of the equation, we continue to see strong momentum in the housing market, with a strong upward trend in existing home sales and housing starts. One positive aspect of the housing recovery on the economy has been the increase in home equity withdrawals by affluent individuals. Instead of using the cash to remodel their home, many are using the cash to invest in the stock market, purchase additional real-estate and even art. The most important conclusion to draw from this is the average household has dramatically delevered from five years ago and now has the lowest debt servicing ratio in more than a decade.

The housing market may still hold the key for sustainable long-term economic growth in the United States. According to the National Association for Home-Builders, every new house built creates roughly three new jobs in the economy. The economy could benefit greatly from housing related hiring, as the current unemployment rate of 7.6% remains uncomfortably high this far into an economic recovery. Moreover, the underemployment rate of 13.8%, which includes those individuals who are marginally attached to the labor force through part-time work, is even more troubling. It highlights the uncertainty corporations are grappling with when making hiring decisions. Instead, corporations are content pushing their workers harder through increased work weeks in order to meet demand rather hiring more employees. Another consequence of corporations’ stalemate on hiring has seen the labor participation rate drop to the lowest level (63%) since 1979, as many people who were looking for work became so discouraged that they completely dropped out of the labor market.
Our Forecast and Strategy

We expect economic growth in the U.S. to remain the strongest of the developed market countries but we do expect a slowdown in economic growth in the second and possibly third quarters due to the Sequester which could shave roughly ¾ of point from growth. Also, the impact from the payroll tax hike on consumer spending will likely be another drag on growth but so far it’s been less than expected. We do see growth picking up again in the later part of the year due to a stronger housing market and increases in capital spending. Recent surveys of Chief Financial Officers have indicated that they intend to increase their investment in capital investment by 50% this year. As a result, GDP should grow between 2.0%–2.5% at year-end, while we expect S&P 500 to earn $100–$110 per share in 2013. Despite the strong run in equity prices from 2009, the major markets are still trading below long-term median valuations. Although U.S. valuations have climbed from 12 times earnings in September 2011 to 15 times today, it still represents a discount to the historical median (since 1955) of 16.8 times. If earnings continue to grow at their current growth rate of about 5%, then we can expect $106.5 earnings per share at year-end. If the market maintained its 15 times price to earnings ratio, the market would trade at 1597.

In Europe, valuations are fairly valued after climbing from 10.5 times earnings (since 1955) to 13.7 times today, approaching the median of 13.9 times since 1970. In addition, austerity measures continue to weigh on economic growth throughout the continent, except for Germany, so we would not be allocating new money to this area at this particular time. However, we do see opportunity in the Asian markets after the Bank of Japan committed to increasing its monetary base. Asian valuations have increased from just more than 12 times to
current levels of 16.9 times, below
the median of 22 times and have
more room to run.

Emerging-market stocks performed
well late in 2012 but have lost their
momentum in 2013. However, we feel
the valuation is justified based on the
long-term growth prospects in this
area. Currently, emerging-markets
are trading at 12.2 times earnings,
a discount to their historical median
15.6 times, and at a 17% discount
to the developed-world equities.
Consequently, we are still maintaining
our overweight position in this area,
as we expect the discount to narrow
during the next five years.

Our view towards fixed income
has not changed much since our
last writing, as we feel the Fed will
stay committed to asset purchases
until there is a substantial change
in employment or with inflation.
Although we feel interest rates will
remain at historically low levels for
the foreseeable future, we still want
to maintain a defensive posture
and be preemptive to when the Fed
does alter its monetary policy. We
are keeping our Bond duration low
while balancing our need for yield
and credit quality. The hunt for yield
has left bonds with a small cushion
to absorb any increase in interest
rates. As a result, we favor High Yield
bonds as we feel it is in the best
position to withstand an increase in
interest rates without a major impact
on price. Whereas low yielding,
ultra-safe bonds like Government
Treasury’s and Agency bonds are in
a vulnerable position if rates move
higher. Going forward, we feel the
10-year Treasury yield will range
from 2.0%–2.5% as we expect some
rotation out of fixed income into risk
assets if our growth forecast comes
to fruition.

We stand by our allocation to
commodities as an inflation hedge
even though current inflation
expectations are contained. However,
as the emerging markets demand
more resources to meet their long-
term growth potential, commodity
prices will increase and those
portfolios with an allocation to this
asset class will benefit nicely.

Our Forecast and Strategy (cont.)

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Conclusion

As risk managers first, our team of investment professionals are constantly monitoring the economic landscape and market factors which may affect our clients’ assets. Since the markets are ever-changing, we must continually monitor whether our clients’ portfolios are diversified based on the risk they are willing to tolerate.

Enterprise Bank to Open 21st Branch in the City of Lawrence

Enterprise Bank is proud to announce the opening of our newest branch office at the Riverwalk in Lawrence, MA. The physical presence of our Lawrence branch is really a natural extension of the decision we made many years ago to invest in the city’s businesses and provide direct support to the non-profit agencies and charitable organizations that have made a profound difference in the lives of so many Lawrence residents.

Enterprise Bank Team Members:
Jesus Suriel, Branch Service Manager; Danissa Lembert, Branch Relationship Manager; Richard Chávez, Commercial Lending, VP; Jack Clancy, Chief Executive Officer

As a reminder, all Enterprise Bancorp Shareholders are invited to attend our Annual Shareholders’ Meeting on Tuesday, May 7 at 4:00 PM at the UMass Lowell Inn & Conference Center, 50 Warren Street, Lowell, MA.
Meet a Member of the Enterprise Investment Advisors Team

Robert M. Lawlor, CTFA, CFP®
Vice President, Senior Financial Consultant

Robert Lawlor brings over 20 years of investment, financial and estate planning experience for individuals, families and non-profit organizations to Enterprise Investment Advisors in his role as Senior Financial Consultant.

Prior to joining Enterprise in 1998, Robert served as a Financial Consultant with Citibank and expanded his valuable trust experience during his tenure at Bank of Boston’s Private Bank.

He holds the Certified Financial Planner™ (CFP) Program designation and the professional designation of Certified Trust and Financial Advisor (CTFA).

Rob was recently awarded Enterprise’s highest reward for his community involvement and active role as a member of the Development Committee for Lowell General Hospital, as well as a Director for Girls Inc. He also holds a seat on the Executive Committee for the Merrimack Valley Estate Planning Council.

At Enterprise Investment Advisors, our mission is to help clients achieve their financial goals by providing professional money management, extensive resources and independent, objective advice that you can trust. Enterprise Investment Advisors was established in 1992 and manages $650 million in client assets. Our clients are successful executives, professionals, entrepreneurs, non-profit organizations, private foundations and retirees who desire a financial partnership that can provide access to investment opportunities and alternative strategies.

www.EnterpriseInvestmentAdvisors.com

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