HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

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HARBOR ADVISORY
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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy* – Tax reform being discussed in Washington would be helpful in restoring a level playing field for U.S. business in the global economy.
- *Our View of the Financial Markets* – Our expectations for 2018 are more muted with our target of 8% total return mirroring our expectation that earnings grow by 8% next year.

LATEST NEWS FROM HARBOR ADVISORY

- You can visit us at: www.harboradvisory.com. Take a look and let us know your feedback.
- Jack De Gan continues to make news with his regular guest appearances on CNBC's top rated financial shows "Squawk Box", "The Call", "Closing Bell" and on Bloomberg TV, Fox Business News and National Public Radio.

THOUGHTS ON THE ECONOMY

Third quarter U.S. GDP growth has been released at 3.0% after the second quarter was revised up from 2.6 to 3.1% growth, the first time since 2014 with growth of 3.0% or better in back to back quarters. Economists' estimates of the fourth quarter growth indicate another print at 3% is possible.

Payroll growth in 2017 is averaging just under 170,000 per month, a reduction from the 184,000 per month we saw in 2016 but a level still high enough to lower the unemployment statistics. The broad U-6 unemployment rate we focus on is now only .5% higher than it was prior to the credit crisis.

Housing starts, which cratered from 2.1 million in 2005 to 550,000 in 2009, are creeping back toward the 25 year average of 1.4 million per year. The latest reading at 1.25 million is still far below the rate needed to keep pace with population growth during the past 12 years.

Corporate earnings growth in the third quarter is running at a rate of 11% adding to the 14% and 12% rates reported in Q1 and Q2. We expect the rate to slow in the fourth quarter to high single digits allowing full year growth in earnings to come in at about 12%.

Tax reform being discussed in Washington would be helpful in restoring a level playing field for U.S. business in the global economy. Moving to a territorial tax system which calls for taxing profits in the country generated but not to be further taxed upon repatriation to the U.S. would allow some of the over $2 trillion held outside the U.S. by domestic corporations to return to our shores to benefit shareholders and employees in this country. The lower rate structure under discussion would raise after tax earnings and reduce the incentive to move outside the U.S. or to build plants in tax haven countries.

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Nod to the ubiquitous disclaimer: While we're not infrequently, and always quite accurately, accused of being of strong opinion – we want to let the reader know we've been wrong before, we will be again, but please don't hold it against us. The forward looking parts of the letter are the best efforts of fallible humans working at Harbor Advisory.

OUR VIEW OF THE FINANCIAL MARKETS

Corporate earnings growth of 13% year-to-date continues to exceed most strategists' estimates for the year and remain the primary driver of stock prices. The shares included in the S&P 500 index have achieved total returns of over 19% as of late November. We expect share prices to hold current levels or possibly even advance slightly to finish the year. Our expectations for 2018 are more muted with our target of 8% total return mirroring our expectation that earnings grow by 8% next year.

Emerging and European markets continue to meet our expectations of a wide outperformance of U.S. shares with the former returning over 30% and the latter over 25% year-to-date. We remain committed to investments in these markets as we believe the 7-10 year under performance recorded by these indices will take at least 3-5 years to mean-revert which would give our investors another 2-4 years of relative outperformance.

Our estimate of returns on fixed income for 2017 have been largely on target with total return of the broad based Lehman Aggregate Bond Index earning near 3% year-to-date.

We believe the Federal Reserve will raise the federal funds rate by .25% in December and by .75% next year which we believe will coincide with the rate increases on longer term bonds with the 10 year U.S. Treasury note yield rising from its current 2.38% to the 2.75-3.00% range. If we are correct, total returns for fixed income in 2018 will be similar to or slightly lower than those achieved in 2017.

HOLIDAY CARDS

In lieu of sending clients holiday cards Harbor will again contribute to a local charity, The New Hampshire Charitable Foundation, which does excellent work for so many great causes in the state of New Hampshire.

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