HARBOR VIEWS

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A LOOK INSIDE HARBOR VIEWS

LATEST NEWS FROM HARBOR ADVISORY

- 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 as well as commentary in the Wall Street Journal and Barron's Magazine.
- You can visit us at: www.harboradvisory.com to see his appearances. Take a look and let us know what you think.

THOUGHTS ON THE ECONOMY

The U.S. economy finished 2011 with a 3% rate of GDP growth in the fourth quarter. The year 2012 started with decent job creation of about 200,000 jobs per month in the first quarter and GDP growth of 2.2%. Job growth has moderated in the last six weeks and is 150,000 jobs per month and GDP growth is likely below 2%. Corporate earnings grew over 6% in the first quarter after growing better than 15% in 2011.

World economic growth has been called into question again over the last month as it becomes clear that voters in Greece and probably elsewhere in Europe are in no hurry to endure years of grinding austerity measures. The severely undercapitalized European banking system is the transmission mechanism for contagion to the U.S. banking system. Greece appears to be close to failing to meet European Union requirements for receiving its second bailout package. This could lead to ejection from the EU and dropping the Euro as its currency. We believe Greece is unable to meet the debt service requirements placed on it and should drop out of the EU.

The European economy is slowing and has shown no GDP growth in the twelve months ended March 31st. The austerity required of Greece, Portugal, Spain and Italy, has only begun to bite on growth and is likely to weaken the economy further. Ultimately, Europe will recapitalize its banks and the ECB will provide liquidity to reduce the risk of a recession or banking crisis. Universally, the hope is that this can happen soon.

China's GDP growth has slowed to 8.1% in the first quarter and looks set to slow further if no stimulus measures are implemented. Annual electricity use, which may be a better indicator of economic activity than the official government figures, is showing no growth. The Chinese government has latitude to lower interest rates of over 6% and reduce bank reserve requirements which stand at a lofty 20%. As well, increased infrastructure spending to stabilize growth, or a combination with the above measures will allow China to avoid a hard economic landing.

Importantly, the worldwide effect of deleveraging will slow world GDP growth and U.S. economic growth will have a hard time averaging much better than 2% per year for the next few years.

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OUR VIEW OF THE FINANCIAL MARKETS

U.S. equity markets started 2012 much as they did in 2011 and 2010. They were strong in the first quarter and then traded lower on European debt contagion fears. This year the trouble has an increasing political component in addition to the financial difficulties. Greeks, after agreeing to severe austerity, appear ready to vote for leaders who will overturn those measures. Spain and Italy are dealing with rioting voters. Clearly if the Europeans don't recapitalize their banks and if one or more of the southern European countries exits the Euro we will experience a flight to safety in the financial markets. The result will be lower equity prices and higher U.S. Treasury note prices.

If European concerns are allayed, the U.S. equity market will trade higher. Corporate earnings last year grew over 15% and this year can increase another 5-7%. Since the S&P 500 advanced just 2% last year and is up only slightly year-to-date, stock prices can rise in line with earnings growth over the two year period and return 10-15% in 2012.

The overhang from Europe has depressed the markets for over two years now and equity prices will respond very positively to the ultimate resolution of the crisis. Resolution will also lead to lower treasury prices as a reversal of the 'flight to safety' trade takes place. Commodity prices will rise anticipating world growth. The dollar would trade lower because most of the safety assets are denominated in dollars.

We expect emerging markets to outperform if the contagion from Europe is contained. They have been hit hard as a slowing world economy weighed on their equity and currency markets.

YEAR OF CHANGE

The year ahead will see Supreme Court decisions about "Obamacare", Congressional approval of major tax code changes, mortgage modification programs, potential changes to educational funding, and retirement of a swath of baby boomers. These changes may have consequences for you or your family or friends. Should you wish to discuss these subjects, we at Harbor stand ready to offer our thoughts on the potential economic aspects of a decision or potential outcome. We encourage you to call if we can be of help.