

HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

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THOUGHTS ON THE ECONOMY

A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy* – The Economy has survived the worst management that Washington can throw at it...
- *Our View of the Financial Markets* – Long Term bond yields should rise to more normal levels over the next few years.

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.

Economic growth rebounded in the first quarter to a 2.5% annual rate after being essentially flat in Q4 2012. We expect 2013 in total to show growth in the range of 2-2.5% which is well below the long-term average rate of 3-3.25%. Job creation in 2013 is running at a rate of 175,000 net new jobs per month at which rate it will take another four years to recover the 8.0 million jobs lost during the great recession. The most telling employment figure is the labor force participation rate of 63.6%. The percentage of the population holding jobs is at the lowest level since 1980 when this statistic was first measured. Much of the rate reduction, from 69% to 63%, is the result of workers unable to find a job who simply exit the workforce. Demographics also play a significant role as baby boomers retire.

The economy has survived the worst management Washington can throw at it as neither the fiscal cliff nor the debt ceiling debacle were able to significantly slow growth.

Estimates of the fiscal year 2013 budget deficit have come down from over \$1.0 trillion to \$650 billion as the economy has strengthened and tax revenues have risen.

The world economy continues to suffer from recession in Europe and much slower growth in the emerging economies as demand for their exports stagnates developed markets. Emerging economies are working hard to rebalance their economies between exports and domestic consumption. As this transition takes place export markets for U.S. goods should expand to meet the demand.

The balance of energy in the world continues to evolve as the U.S. dramatically expands domestic production of gas and oil. At the same time domestic consumption has moderated as we conserve energy and shift to more fuel efficient vehicles. It is difficult to overstate the importance of this shift and its long term effect on Americans. We become more productive and our comparative advantage increases as our energy costs decline versus our trading partners. This will provide a multi-decade tailwind for U.S. economic growth.



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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

The U.S. equity market is having another strong year. Broad stock indices are already at the upper end of our 10-15% return assumption for 2013. We expected that if we were wrong, it would be from being overly conservative. We now believe that to be the case this year.

Reasonable stability in Europe and China have allowed the depressed equity valuations of 2011-2012 to rise a bit with the S&P 500 now trading at about 15 times expected 2013 earnings, which is the long-term average for share valuations. During most secular bull markets share prices migrate from undervalued to fairly valued to overvalued over the course of the advance. We are currently in 'fairly valued' territory which means we should have further to go both in terms of earnings growth and valuation expansion. Dividend increases continue to run at a record pace, and along with share repurchases, help put a floor under equity prices. Discussion of tax reform in Washington has picked up steam as companies borrow to raise dividends and repurchase shares as opposed to repatriating foreign earnings. Any change in the corporate tax landscape would be good for equity valuations.

Treasury yields have again moved toward the upper end of the 1.4 - 2.1% range for the last year. We expect the Federal Reserve to remain in accommodative mode for all of 2013 and into 2014. Long-term bond yields should slowly rise toward more normal levels over the next few years. Harbor continues to maintain a very short average maturity on our debt holdings to hedge against interest rate risk.

ESTATE PLANS

New 2013 federal estate tax rules allow \$5.25 million per person to pass without tax allowing many couples with up to \$10.5 million estates to relax. However, states have not been so "giving". Many states retain \$1 million per person, or \$2 million per couple, as a level at which citizens should monitor the potential tax results of their current estate plans. Remember, assets held in joint name don't always optimize estate tax outcomes. If you have questions, consult a qualified trust and estate administration attorney who is admitted to practice in your home state.