

HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

Winter 2010



A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy...* We believe 2011 could see twice the job creation of 2010.
- *Our View of the Financial Markets –* Economic growth of emerging markets should remain strong this year...

LATEST NEWS FROM HARBOR ADVISORY

- You can now 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

We are more positive on the U.S. economy coming into 2011 than we have been in three years. Much of our optimism surrounds the employment and housing markets. After a slow year in 2010 when slightly over one million new jobs were created 2011 could see twice that many new jobs created. This will increase consumer confidence and also business confidence which should lead to increased capital spending. The residential real estate market appears to be bottoming on the lower priced end which should lead to increased optimism and spending as well as increased bank capital and profits.

Economic growth in 2011 should top 3.0%. Though much of this continues to be the result of government fiscal and monetary stimulus, a double dip recession is unlikely and growth will be self sustaining. In this environment corporate profits can continue to grow leading to increased hiring and spending.

The direction in policy and rhetoric out of Washington appears to have turned less antagonistic toward business which will support growth.

Higher oil prices, increased regulatory burden and healthcare costs remain as headwinds but should not derail the recovery. Along with stronger growth we can expect higher interest rates which are a natural part of an economic recovery.

Growth in our emerging market trading partners remains robust and helps offset the sluggish growth in Europe. The outlook for the emerging countries and their currencies remains positive on a long term basis.

OUR VIEW OF THE FINANCIAL MARKETS

The financial markets performed better in 2010 than we feared at the outset. A potential double dip recession and European currency and debt contagion did not weigh on stocks in the U.S. as much as we thought they might. Our performance was good in the first half of the year but lagged as equities recovered in the latter half of the year.

We began to increase equity exposure in September and continued to add through year end. Coming into 2011 we believe the risks to the economy and to equity performance are reduced, and expect market



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returns in keeping with historical norms which should track corporate earnings growth of 8-12%.

Large capitalization blue chip stocks like many that we own for our clients are poised to have a better year relative to smaller companies in 2011. The more defensive names we own should perform well as the rate of recovery in earnings and economic growth moderate this year. Health care stocks which have been held back for the last two years due to the health care reform laws may catch up a bit as those rules are tempered this year.

The fixed income markets face the headwinds of the inevitable rise in interest rates which accompanies an economic recovery. Our fixed income holdings are primarily inflation adjusted or short maturity higher yielding corporates which benefit from stronger economic growth. Short maturities will reduce the negative impact of higher interest rates.

The economic growth of emerging economies should remain strong this year and we have added to our holdings to take advantage of this strength. These economies will see strength in their currencies against the U.S. dollar which should add to returns.

TAX REPORTING

You may have already read a letter we send out regarding the new Treasury mandated reporting of gains and losses by custodians. The custodians of Harbor client assets (Pershing, Wells Fargo, Merrill Lynch, etc.) will be required to begin supplying the IRS with gain/loss information in 2011. Initially this information will be incomplete but will become more comprehensive over time. As you know, Harbor has always provided this information to our clients as a courtesy since the custodians did not provide the information to the IRS. It is our experience that our cost basis differed in many cases from the information maintained by the custodians for a variety of reasons: dividends that included returns of capital being treated differently, bond premiums and discounts being accreted or amortized differently, etc. To avoid confusion and therefore potential inquiries from the IRS, Harbor will transition gain/loss reporting to the custodians. What this means is that clients will provide their tax preparers with the custodian bank Form 1099 and year end statements to calculate gains/losses. Harbor will continue to provide a letter with management fees paid by those clients for whom the custodian does not provide this to allow the fees to be taken as a miscellaneous investment expense for those who qualify. Once fully implemented, this process should be easier for the tax preparers.

In 2010 Harbor purchased a couple of publicly traded partnerships (Spectra Energy and Brookfield Infrastructure Partners) for many clients. These investments file a Form K-1 for tax purposes that should be available by March 15th. This form must be provided to your tax preparer as the information may not be contained on the Form 1099 from the custodian.



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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.

TAX RATE EXTENSION

A surprise compromise in Washington has led to a two year extension of the income, capital gains and dividend tax rates set during the Bush administration. As additional stimulus, the bill also included a one year reduction of 2% in employee paid social security taxes as well as a 13 month extension of emergency unemployment benefits.

Federal gift and estate taxes were also modified allowing for a unified gift and estate tax credit of \$5.0 million per person with a transfer mechanism to allow couples to use the full \$10.0 million at the second death if they wish. The gift tax goes from \$1.0 million to \$5.0 million.