HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

Winter 2013

HARBOR ADVISORY

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy* – Bright spots continue to be U.S. residential real estate and auto sales.
- *Our View of the Financial Markets* – Companies remain cash rich and dividend increases and share repurchases can again be an expected tailwind for share values.

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

The U.S. economy finished the year with a positive .1% rate of growth in GDP in the fourth quarter. The headline figure sounds much worse than the underlying details however. Real final sales were close to 2% which is a better indicator of what people are actually spending and probably reflects a rate of growth in GDP which we may achieve for the year as a whole.

Exports ground to a halt as Europe slipped further into a recession and the developing world stabilized. The bright spots continue to be U.S. residential real estate and auto sales, the two biggest expenditures in consumers' budgets. After four years in near depression, housing starts are again adding to output and annualized auto sales now top 15 million units.

The fiscal cliff passed with tax increases enacted on higher income earners and the expiration of the 2% reduction in social security withholdings. This creates a modest drag of .25-.50% on annual rate of growth. The spending reductions agreed to in 2011 now take effect in the form of the sequester as our legislators could not agree on a more rational allocation of spending reductions.

These cuts, which amount to immediate spending reductions on the order of $45 billion annually, will reduce GDP growth by another .25%. Now we must face the filing of a new budget and the fight over funding the government under a continuing resolution as there is no budget in place for the fourth straight year. The government deals with each deadline by deferring hard decisions far into the future, forcing future politicians to deal with more onerous choices and consequences.

Oil prices in the mid $90's per barrel are probably near a high. As long as they don't go significantly higher growth will probably not be significantly impaired. We believe GDP growth will approximate 1.5-2.0% for 2013 allowing corporations to increase profits for a fourth year.

HARBOR ADVISORY
WWW.HARBORADVISORY.COM

Phone:
603-431-5740

Fax:
603-431-2927

500 Market Street,
Suite 11,
P.O Box 4520
Portsmouth, NH
03802-4520

harboradvisory.com

Harbor Views is written and produced by Harbor Advisory.

Jack De Gan
Editor

Weld Butler

Joan Gordon

Jan Yeaman

Cheryl Crowley

OUR VIEW OF THE FINANCIAL MARKETS

The U.S. equity market finished 2012 with a gain of over 15% in the S&P 500 which was at the high end of our expectation. We believe 2013 can again be a 10-15% return year for domestic equities. At this writing in late February the S&P 500 has gained about 6% year-to-date. We expect the emerging markets equity indices to also return double digits as their export markets stabilize in Europe and grow modestly here in the U.S.

Valuations remain reasonable for U.S. shares as the S&P 500 currently trades for about 14 times 2013 expected earnings. Companies remain cash rich and dividend increases and share repurchases can again be an expected tailwind for share values.

Fixed income prices have slipped modestly year-to-date as the rate on the 10 year U.S. Treasury note has risen to 1.9% from 1.5% at the time of our last letter. Rates will continue to rise in an uneven manner over the next few years which will make owning long duration fixed income assets painful.

We continue to hold primarily short term bonds for clients which will be much less sensitive to the rise in rates. We are using an opportunistic approach to finding value in the bond market as increased merger activity has occasioned short term disruptions.

As the bond markets become less attractive and the equity markets continue to offer long term value we have migrated our clients' asset allocation ratios toward higher equity allocations.

IRA DISTRIBUTIONS AS CHARITABLE GIFTS

Each year IRA owners over the age of 70 are compelled to make a Required Minimum Distribution (RMD). Our Congress has again extended for 2013 a rule allowing up to $100,000 of RMD to be used as a direct gift to charity. Clients considering significant charitable gifts should consult their tax preparer about the benefit of this rule as compared to gifting of cash or even appreciated securities.

DON'T RUSH TO FILE TAX RETURN

Many Harbor clients hold Brookfield Infrastructure Partners, L.P., a Master Limited Partnership. The company sends its tax report (Form K-1) directly to owners but not until the week of March 20th.