

HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy* – In 2014 we believe GDP growth can trend closer to 2.5% growth which would help corporate profits to advance by 6-8% this year.
- *Our View of the Financial Markets* – “Uncertainty over the situation in China will be the major headwind for equity markets in 2014.”

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 advance GDP report for the final quarter of the year showed the U.S. economy growing at 3.2% which brought the full year figure to 1.9%. This rate continues the average of 2% economic growth achieved since the end of the recession in the summer of 2009.

Employment markets strengthened in December to bring the average monthly job gains to about 170,000 for the year. The unemployment rate of 6.7% declined, primarily as a result of workers leaving the workforce. Labor force participation rate remains mired at 40 year lows below 63%.

The Federal Reserve has now made two successive \$10 billion reductions in the rate at which they purchase government securities each month. Markets anticipate the program will be wound down by mid-year.

Weakness in emerging markets currencies in the last six months has been attributed to reduction in liquidity by the Fed. But we believe there are fundamental factors at work in each of the underlying economies as well.

Record levels of domestic natural gas and oil production continue to benefit America's economy by holding energy prices here well below world levels. Gasoline prices remain 50 cents per gallon below year ago levels and natural gas feed stocks for our manufacturers continue to provide a competitive advantage.

OUR VIEW OF THE FINANCIAL MARKETS

Stock prices had a good year in 2013 with the MSCI-World Index advancing by 22.80% on the year. Equities in Japan and the U.S. had higher returns and the emerging markets again showed negative returns. Share prices have been falling in 2014 with the S&P 500 lower by 3% in late January and emerging markets falling by twice that amount.



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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.

Equities are fairly valued at the current level with the S&P 500 trading at 15.3x 2014 earnings. We see the emerging markets as undervalued at 9.1x 2014 earnings. These valuations suggest to us that U.S. stocks could provide returns of 6-10% in 2014 as combined earnings growth and dividends should fall within that range. Emerging markets shares could show higher returns as valuations have room to expand.

The current concerns in equity markets relate to credit markets in China and growth rate of the Chinese economy. Current government estimates from China indicate growth in the range of 7-7.5% as exports slow.

The new government in China is working to transition economic growth from an export related focus toward an emphasis on domestic consumption. This transition could take many years and is by no means certain to be without interruption.

The "shadow banking" credit markets in China have provided a boost to investment in the last few years and many worry that the quality of these loans is low and delinquencies could rise. We share these concerns and believe uncertainty over the situation in China will be the major headwind for equity markets in 2014. Ultimately, China may need to tap into its foreign currency reserves of over \$3.5 trillion to bolster the banking and shadow banking systems.

Fixed income indices posted their first negative returns in 2013 in many years. We expect bond returns to be in the low single digits in 2014 as interest rates rise as a result of a stronger economy and a less accommodative Fed.

TAX SEASON MILEPOSTS

Tax return preparation season is upon us and some dates deserve reciting:

January 31st – Form 1099's mailed for accounts with no income reclassification.

February 18th & 28th – Form 1099's mailed for accounts with updated income reclassifications or revisions.

March 7th – Brookfield Infrastructure Partners L.P. K-1 information is expected to be available at www.brookfieldinfrastructure.com. This information will **not** be provided by Pershing and can only be gotten directly from this website.

You may wish to discuss with your tax return preparer the best and most efficient way to provide information knowing that revisions in 1099's can come late into February and K-1's won't arrive until March 7th or later.