HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

Winter 2017

HARBOR ADVISORY
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A LOOK INSIDE HARBOR VIEWS

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- *Our View of the Financial Markets* – Warren Buffett was quoted on CNBC on Monday, February 27th as stating that "if you are allowing your political views to drive your investment decisions you are making a mistake."

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

GDP advanced in the fourth quarter at a rate of 1.9%, which brings the full year 2016 economic growth back to the 2% average which has prevailed since the end of the recession in June 2009. We expect U.S. GDP to advance by about 2.5% this year.

Job growth in 2016 averaged 187,000 per month bringing the unemployment rate down to 4.7%. The U-6 rate, more commonly called the 'underemployment rate', fell to 9.2%. Included in the U-6 are those out of work but no longer looking for work, sometimes called the 'discouraged workers' and those employed part-time who would like to be working full-time. Wages increased by 2.9% after inflation which is the greatest pace since 2009.

The dollar has risen another 3.5% since the election as expectations for U.S. growth, interest rates and inflation have risen. This creates headwinds for multinationals while making U.S. products less price-competitive in foreign markets.

Auto sales have plateaued at a 17.5 unit million annual rate in the U.S. while home sales have stalled as mortgage rates have increased 75 basis points since last summer.

Oil prices are near two year highs with Brent Crude trading at $56.50 as I write. This should lead to a recovery in earnings growth as oil companies begin to recover from two years of crushing earnings declines. The earnings growth of the companies listed in the S&P 500 should approximate 8-9% this year, continuing a recovery from 5 quarters of negative growth which ended in the 3rd quarter of last year.

Corporate tax reform looks like a real possibility for 2017 if the issue of the 'Border Tax Adjustment' can be resolved. The BTA is a way of raising $1 trillion in tax revenue by disallowing the deduction of imported goods in corporate tax returns while continuing to allow the deduction of domestic goods, essentially taxing imports but not exports.

The BTA is also designed to discourage offshoring as well as corporate inversions which are a way to change tax domicile to a lower tax country.

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OUR VIEW OF THE FINANCIAL MARKETS

The return on broad-based U.S. equity indices in 2016 improved further between the election and year's end with the S&P 500 gaining 11.96% for the year including dividends. This return bested our estimate of 6-8% for the year. Let's hope for a return performance in 2017.

The consensus of chief investment strategists on Wall Street for equity returns in 2017 is for the markets to provide a 5% total return. Since the equity markets rarely reward the consensus, we expect the actual return to be materially higher or lower. We are taking the over with an estimate of a 10-12% total return. Our confidence level in this estimate is not high as we have proven to ourselves we are very poor at guessing political outcomes and there is considerable political risk to the 2017 economic outlook. Warren Buffett was quoted on CNBC on Monday, February 27th as stating that "if you are allowing your political views to drive your investment decisions you are making a mistake." We agree with Buffett as we usually do. There is a reason he is called the "Oracle of Omaha"! We will continue to base our investment decisions on our economic outlook and the operating metrics of the companies in which we invest.

The fixed income markets suffered after the election as investors' estimates for economic growth, inflation and interest rates increased, lowering bond prices and returns. The Lehman Aggregate Bond Index earned 2.65% for the year. Our expectations for 2017 are again for low single-digit returns.

We think 2017 could be the year that our emerging markets and European index holdings outperform the U.S. equity markets, a position you have heard from us on more than one occasion. This year we hope to be right!

Published 3/2017