HARBOR VIEWS

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HARBOR ADVISORY

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A LOOK INSIDE HARBOR VIEWS

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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 and National Public Radio.

THOUGHTS ON THE ECONOMY

Output of the U.S. economy expanded for the first time in five quarters in the June to September period as GDP advanced 3.5%. This improvement required heavy government intervention to achieve as consumers were offered up to $4,500 to buy a car and up to $8,000 to buy a home. It would be hard for the economy not to benefit from such generous handouts. The massive $787 billion stimulus bill has also helped consumer spending which expanded 3.4% during the 3rd quarter.

We are also pleased to relate the residential real estate market, which was the epicenter of the financial meltdown, has improved in unit sales for seven months and in price terms for four months. We will be closely watching these figures as we enter the seasonally slow fall and winter period for real estate and as the $8,000 credit for first time home buyers expires. Commercial real estate is still weakening which represents another problem for bank balance sheets.

Unemployment is now 9.8% with the broader underemployment rate, which includes discouraged job seekers and those employed part time, running at 17%, or nearly 24 million people. The loss of jobs in this recession has been breathtaking and will weigh on banks further as debtors find it harder to meet obligations.

We believe the economy can stage a slow recovery over the next few years with unemployment declining slowly and real estate prices stabilizing during 2010. The Federal Reserve is allowing some of its extraordinary liquidity programs to expire as it begins to focus on ways to position for inflation control as the economy recovers. The economy must now deal with enormous budget deficits projected at over $1 trillion per year in each of the next ten years, and the eventual tax increases to pay for them.

OUR VIEW OF THE FINANCIAL MARKETS

The recovery in stock prices since March has been dramatic as the unprecedented liquidity employed by the Federal Reserve has found its way into the financial markets. Corporate earnings growth has been impressive as the benefit of cost cutting and productivity gains from layoffs fall to the bottom line. With the economy now stable, albeit with significant government assistance, earnings growth will require higher revenue growth fueled by consumer and corporate

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spending as the huge government stimulus is gradually wound down. Share valuations are now back to long-term historical averages, and are not inexpensive in light of the economic situation we are in. We remain cautious and believe capital preservation should remain a top priority.

Bond markets also have benefitted greatly from the Fed liquidity boom. Credit spreads, representing how much borrowers must pay over low risk treasury yields, have contracted from historical highs to average levels, allowing our bonds to appreciate nicely. As the economy has stabilized and concerns begin to shift toward inflation, our TIPs (treasury inflation protected securities) are appreciating nicely as well. We will look to put more money to work in the fixed income markets over the months ahead.

TO ROTH OR NOT: CONVERSION REDUX

Beginning in 2010, any taxpayers will be able to "convert" existing Individual Retirement Accounts (IRA's) to Roth IRA's (RIRA's). Prior to this, only taxpayers with $100,000 or less of adjusted gross income were allowed conversion. Simplified, the "conversion" amounts to paying all taxes due on the tax deferred IRA holdings. In a special twist the law allows 2010 conversions' tax liabilities to be paid over the two subsequent tax years, further sweetening the option.

Roth IRA investments are uniquely not subject to income tax: ***NO*** taxes on dividend or interest income or capital gains. Individuals favorably inclined to convert existing IRA's to Roth IRA's share one overarching assumption: their tax rates are likely to increase in future years.

IRA's and all other deferred tax retirement plans have always relied upon the basic mathematic assumption that deferring tax payments from higher tax rates in earning years to a lower tax rate during retirement will result in more dollars retained by the taxpayer. For successful investors, that assumption became suspect after the Bush tax cuts featured generous reductions on rates for investment assets. Given the current prognosis for the higher tax rates to pay for gaping government deficits, the value of tax deferral is even more questionable. As always, taxpayers should seek expert guidance from tax counsel for this unique and complex decision.

HOLIDAY GIFT

In lieu of sending Holiday cards this December, Harbor Advisory will be making a gift to The New Hampshire Charitable Foundation. This Foundation has been working to improve the quality of life in New Hampshire communities since 1962. In view of the outpouring of need in our difficult economic times we are proud to help our community.