HARBOR VIEWS

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy* – The savings from low oil prices have yet to show up in consumer retail spending.
- *Our View of the Financial Markets* – Our outlook for European share prices is considerably more upbeat.

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

Just released U.S. economic growth numbers show the third quarter of 2015 growing 1.5% after inflation. The subcomponents were stronger with real final sales notching almost a 3% rate of increase. The strong subcomponents do not alter the longer term trend which will show 2015 growing about 2%, or in line with the tepid 2% rate since the 2009 recession.

The labor markets are still creating jobs at a rate between 150-200,000 jobs per month which is a slowing from over 200,000 earlier in the year. The Labor Force Participation rate at just 62% remains at a 40 year low. Clearly some of the decrease from over 67% in the LFPR represents retiring Baby Boomers but there are also significant numbers of discouraged workers who have exited the work force. Wage rates continue to increase at an annual rate of just over 2% which, when combined with a greater employment base, increase purchasing power.

The low level of energy costs remains a bright spot for consumers as well as businesses. Oil trading at $45/barrel and natural gas at $2.00/MCF add dramatically to household purchasing power as well as lowering business input costs. These savings have yet to show up in retail spending even though auto sales are near a record at 18 million units in U.S. car sales. Home sales are higher year over year as well. It is retail sales of non-durable goods which have yet to accelerate. I have stated in previous letters that a lag would exist until consumers believed that $2.00/gallon gas was more than a temporary phenomenon, but this theory is getting a bit long in the tooth.

The strong dollar is hurting international sales of U.S. multinationals more than I and many other observers had expected. Consequently, corporate earnings through the first three quarters of 2015 are running negative by single digits. Exempting energy sector earnings, S&P 500 earnings are positive by 3-4%.

We expect the rate of economic growth to continue to run at 2% until we can get fiscal policy action to reform personal and corporate taxes, restructure government spending and reduce the regulatory burden on businesses.

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OUR VIEW OF THE FINANCIAL MARKETS

The third quarter of 2015 was a volatile one for world equity markets. The concern about a slowing of economic growth in China, mentioned here in our summer edition, contributed to a 10% correction during the months of August and September. This China concern was cited by the Federal Reserve in their September meeting as one reason they held interest rates at zero. Markets now expect the first rate hike to take place in December. Equity markets in October have rallied to recover almost all of the ground lost in the late summer correction.

We expected equity returns in 2015 to approximate corporate earnings growth plus the dividend rate or about 6-8%. Earnings have been weaker than we expected primarily due to the strength in the dollar and the weakness in oil prices. Reaching our initial goal is still possible but is now a stretch goal. Returns could come in a few percentage points below that level.

Our outlook for European share prices is considerably more upbeat. We expect accelerating economic growth and earnings as well as a higher dividend yield to allow European equities to outpace U.S. shares for the next few years.

Emerging market equities also trade at significant discounts to U.S. shares and should outperform in the intermediate term although an immediate catalyst is not yet visible.

The bond market continues to confound as the ten year Treasury yield is essentially unchanged from the 2.14% it traded at the end of 2014. Our expectations remain for low single digit bond returns in 2015.

SEA CHANGE

The recent ascension of Paul Ryan to Speaker of the House and passage of a budget bill avoided a threatened shut down of the government. It may signal the beginning of an era of legislative movement in an otherwise frozen Washington. If true, this could lead to dramatic shifts in areas of taxation and government spending. To wit, the budget legislation ends an option available to couples entering retirement called "file-and-suspend". This strategy allows the higher earning spouse to file for a retirement benefit at full retirement age and immediately suspend the benefit, allowing the payment to increase by 8% per year until age 70. At the same time, the other spouse can file for and begin receiving a 50% spousal benefit immediately. In an era where politicians are facing gaping deficits and a growing cry to address them, this may be the first of many changes we will see.

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