HARBOR VIEWS

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HARBOR ADVISORY

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy – The trade tariffs put in place by the administration began to take effect during the third quarter.*
- *Our View of the Financial Markets – We think there were three primary reasons: trade tariffs, tentative earnings guidance and the oil price collapse.*

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

Third quarter GDP growth was reported to be 3.5% which brings the year-to-date rate of growth to just over 3%. The U.S. remains a pillar of strength among developed economies as both Germany and Japan, the number 3 and 4 economies in the world, posted contracting output in the third quarter.

Job growth continues to be impressive with year-to-date payroll jobs increasing at a rate of 212,000 jobs per month. Since working age population grows about 80-100,000 persons per month, more than 100,000 people each month have gone from unemployed status to the ranks of the employed. October employment report wage increases grew 3.1% year-over-year. Both of these dynamics add to personal income driving consumer spending which represents about 70% of output.

Energy prices, as measured by Brent Crude prices, rose sharply for the first nine months of this year and have since fallen almost 25% in the last six weeks. While this price action has many inputs, one is U.S. supply which has increased sharply to a record 11.6 million barrels per day currently. Estimates of future demand for oil are being tempered as economies outside the U.S. show slower growth. Politics are always a factor in global oil markets and this period is no exception. The U.S. sanctions recently imposed on Iran were expected to reduce supply to the global market until the administration issued waivers to 8 large oil consuming economies which took the oil markets by surprise.

Natural gas prices have increased sharply this fall as a cold start to the heating season met with lower than historical supplies in storage. Since natural gas is an input to many manufacturing processes these high prices will weigh negatively on corporate earnings if they persist.

The trade tariffs put in place by the administration began to take effect during the third quarter. These "taxes" have multiple effects on the economy including increasing input costs and import prices. Uncertainty surrounding costs, supply chains and tariff retaliation makes companies' strategic planning difficult and acts as a brake on growth. During third quarter earnings calls CEOs discussed tariff issues, including a higher dollar, as a leading reason to lower earnings expectations guidance. We believe the greatest headwind our economy faces is the negative effect of the trade war. If the trade issues are not resolved and continue to escalate, they could lead to a recession.

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OUR VIEW OF THE FINANCIAL MARKETS

U.S. equity markets performed well through the first nine months of the year. In October the equity markets surrendered much of their year-to-date gains. We think there were three primary reasons: trade tariffs, tentative earnings guidance and the oil price collapse.

Trade tariffs began to take effect in the third quarter and led senior executives to reduce future earnings guidance and to reduce capital investment. Tariffs also helped push the U.S. dollar higher which reduced international earnings and competitiveness. Sharp oil price declines called into question demand and thus the strength of economies worldwide. Corporate earnings growth through the end of the third quarter were running at an impressive 25% rate of increase, about one third of which is the effect of lower tax rates. Calendar 2018 should finish with earnings growth over 20% which would make the forward price/earnings ratio about 16x. This leaves U.S. stocks with a reasonable valuation only slightly above the 5 year average.

It is difficult to handicap how geopolitical events will play out. We believe if the trade war can be de-escalated the equity market can recover and end the year with high single digit returns.

The fixed income market is dealing with the prospect of four interest rate increases this year by the Federal Reserve and the effects of a stronger economy. The rate on the 10 year treasury has increased from 2.4% in January to 3.1% in November which has produced low single digit negative returns on bonds this year. Harbor clients own a number of variable rate securities and higher yielding short-term bonds which are producing positive returns this year.

YEAR-END GIFTING

Many clients gift to charities of their choice before year-end. Again this year the tax laws allow charitable gifts made directly from an IRA to a charity to satisfy IRA Required Minimum Distributions. Alternatively, the time honored method of gifting of appreciated securities serves to gift away the "embedded gain" tax liability while benefitting a charity. Should you wish to do either we strongly recommend informing us by December 17th so that we can safely complete the gift in this calendar year.

HOLIDAY CARDS

In lieu of sending clients holiday cards Harbor will again contribute to a local charity, The New Hampshire Charitable Foundation, which does excellent work for so many great causes in the state of New Hampshire.

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