

HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy – The trade war played havoc with the economy in many ways.*
- *Our View of the Financial Markets – An interview with Fed Chairman Powell eased fears of overly restrictive monetary policy slowing the economy.*

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 U.S. economy expanded output by 2.6% in the final quarter of the year bringing the full year 2018 output increase to 3.1%. This is the strongest calendar year GDP growth in over a decade.

Much of the economic strength came from consumer spending which expanded at a rate of 2.8%. Since personal consumption represents almost 70% of national output, job creation and wages are very important. Last year 2.64 million non-farm payroll jobs were created, or over 222,000 each month, well in excess of the 100,000 per month required to keep up with expansion in the labor force. Wages increased by 3.1% during the year outpacing consumer price inflation growth of about 2.2%.

International economies weakened sharply toward the end of 2018 with Europe growing GDP by 1.8% for the year and Italy falling into recession territory with two consecutive quarters of negative growth.

Energy prices tumbled late in the year as expectations for growth in world demand were diminished. Oil prices collapsed by a third before stabilizing at year-end.

Fear of monetary policy errors by the Federal Reserve on trade policy by the Administration caused risk asset prices to correct sharply into year's end. The Fed shocked the markets in October when Chairman Powell declared interest rates to be "far from neutral." The Chairman walked that language back dramatically in January which sparked a sharp rally in risk markets.

The trade war played havoc with the economy in many ways. Examples include higher input costs from tariffs on aluminum and steel, reduced capital investment, supply chain chaos and reduced risk taking by business leaders.

At year-end the U.S. government stopped paying all "non-essential" personnel for 35 days which also slowed spending and reduced retail sales. Harbor expects GDP growth to slow in 2019 to between 2.3% and 2.5%.



WWW.HARBORADVISORY.COM

Phone:
603-431-5740

Fax:
603-431-2927

500 Market Street,
Suite 11,
P.O Box 4520
Portsmouth, NH
03802-4520

harboradvisory.com

Harbor Views is written and produced
by Harbor Advisory.

Jack De Gan
Editor

Weld Butler

Jan Yeaman

Cheryl Crowley

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.

OUR VIEW OF THE FINANCIAL MARKETS

Equity markets around the globe fell sharply into year-end as economic weakness internationally and policy error concerns in the U.S. drove risk markets lower. Share prices in the U.S. decreased 20% by Christmas Eve before a sharp rally ensued. An interview with Fed Chairman Powell eased fears of overly restrictive monetary policy slowing the economy. In calendar year 2018 the S&P 500 fell by 4.4% and total returns in the U.S. corporate bond market were unchanged. 2018 closed with 90% of asset classes showing negative returns, a very unusual occurrence.

Corporate earnings for 2018 however, increased by over 22% with revenue growth topping 8%. Dividends on the broad indices increased almost 10%. Equity valuations contracted from 18x to 13.5x from the beginning of the year until Christmas Eve before increasing to about 15 times earnings at year's end.

The trade war put upward pressure on the US dollar causing it to gain 7% against a trade-weighted basket of foreign currencies in 2018. This in turn decreases the dollar value of international shares and lowers foreign based earnings of US companies.

By the end of February, equity prices had recovered much of the late 2018 losses with the S&P 500 trading near 2800 or 16x 2019 operating earnings per share. Harbor expects corporate earnings to grow in 2019 by 5-7% and dividends to increase by 3-5% which we think can add another 5-8% to stock prices.

Fixed income returns finished 2018 almost unchanged and may provide low single-digit returns in 2019 as the Federal Reserve shows patience on monetary policy.

TAX SEASON PHISHING

It is tax season again and the IRS has issued renewed warnings of scammers and hackers trying to steal identity and/or money. Specifically, phone calls claiming to be IRS tax collections or "IRS" emails claiming to need information MAY BE BOGUS. The IRS doesn't call to demand payment or information. They use the mail. Don't fall victim to claims of urgently required response. If you have any question about legitimacy, contact the IRS directly.

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