HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

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HARBOR ADVISORY

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy* – So where is the pony?
- *Our View of the Financial Markets* – ...equity markets provide the highest level of forward returns immediately following major declines.
- *Stimulus Benefits* – the stimulus bill has goodies for almost everyone.

LATEST NEWS FROM HARBOR ADVISORY

- We have recently updated our website! The new features include a shorter URL! 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" and "Closing Bell" and recently on Bloomberg TV.

THOUGHTS ON THE ECONOMY

The economy remains deeply mired in the worst recession since the 1930's with almost 2.0 million jobs lost in the first three months of this year versus 2.6 million lost in all of 2008. Industrial production and global trade are falling at the greatest rates since the end of WWII. The IMF (International Monetary Fund) expects world GDP to decrease by 1.9% in 2009 - again the worst showing since the 1940's.

President Reagan famously asked "so where is the pony" as a lighthearted way of emphasizing there must be something good among all the bad. The pony we see is a decelerating ***rate*** of decline in many economic indicators. Moderation in the rate of descent takes place before leveling off and getting the plane safely on the ground. This recession is about the bursting of the real estate bubble and the inevitable deleveraging that followed. The rapidly decreasing value of all forms of real estate based debt and its derivatives is what blew a hole in bank balance sheets. Real estate values must bottom before we can stop the bleeding in the financial sector and get credit moving in our economy more freely.

Residential real estate prices nationwide have fallen 29% since the top according to the most recent Case/Shiller Index. New housing sales have fallen 75% and inventories of unsold homes are now down 9% in March year over year. Housing affordability is at its most attractive level in 40 years. Residential real estate prices should bottom by year's end which will allow banks to begin building capital again.

Commercial real estate however is not as far along the road to recovery and will fall significantly further before bottoming representing another obstacle for the banks. The Fed and Treasury are heroically trying to provide credit to all sectors to keep the economy from slipping even further, with mixed results. The attempts to deal with the securitization markets (TARP) and the toxic assets (PPIP) are meeting with little enthusiasm from investors due to fear that Congress will intervene in the management of the companies who participate.

We continue to believe 2009 will be the worst year for our economy, and the good news is that we are now one-third the way through the year! 2010 will be a transition year in our estimation on the way to recovery in 2011.

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OUR VIEW OF THE FINANCIAL MARKETS

We continue to favor capital preservation as of this writing as we believe each rally in this economic environment must be considered a bear market rally until proven otherwise. In our last letter we conjectured that significantly lower stock prices could be in our future and that indeed was the case in early March. At the low on March 9th the S&P 500 was down 57% from its high in October of 2007. The question now is will that low hold and can we look forward to higher prices as the economy recovers. We are not convinced the low will hold, but we are sure prices will be higher in the recovery which should still happen in 2009 anticipating the economic turn later this year or in 2010. If we retest the March lows or go lower, we could add to our equity holdings as we did earlier in March with our additions to our GE positions. For now we are pleased with corporate bond investments made late last year which have appreciated while providing a high level of current income to our client portfolios.

The worst of the credit crisis has passed as witnessed by the fact that we are no longer actively discussing the potential collapse of the banking system. The markets are now dealing with the economic effects of that crisis, and stock prices have seen the worst of their decline already. The important thing to remember about equity markets is they provide the highest level of forward returns immediately following major declines.

STIMULUS BENEFITS

The stimulus bill has goodies for almost everyone!

- $8,000 tax credit for home pruchase
- Deductions for sales taxes paid on the purchase of a new car
- Tax credits for installing alternative energy
- Reductions in withholding taxes for some
- $250 additional payment to Social Security recipients

Check with your tax advisor for details.

MORTGAGE RATES

The Fed continues its efforts to keep mortgage rates at historic lows of 4.75% - 5% which represents a tremendous refinancing opportunity. Debt management is critical to a household's balance sheet. A reduction in monthly mortgage expense for qualified borrowers is easily the lowest hanging fruit to improve one's financial health in these troubled times. For example a $350,000 mortgage balance at 6% can be refinanced at 4.75% for annual cashflow savings of $3,200. We will look back on this time and for those that do have mortgage debt there will be lifetime bragging rights comparing low rates for those that move now.