



HarborViews

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Thoughts on the Economy

If you have not heard us say the U.S. economy is nothing if not resilient we'll say it one more time here. The economy has expanded at a 1.8% real (after inflation) rate in the twelve months ended June 30th. The credit crunch we anticipated to spill over from subprime mortgages to the broader credit markets happened in the third quarter with dramatic results. The credit markets for risk debt "seized up" and caused a 10% correction in the stock market with much hand wringing by economists. Slower job creation over the summer months and continued deterioration in home prices brought forth predictions of recession and further difficulties for the securities market.

The risk of recession has risen as oil approaches \$100 per barrel and the debt markets continue to struggle. We believe however, the odds of recession are even at best. The world economy remains very strong, growing at a nearly 5% real rate even as the U.S. has slowed.

This may be the first cycle where the U.S. coughs and the world does not catch the flu. We expect the chances are even or better that the current slowdown lasts another year and then growth strengthens as the real estate depression bottoms. The Federal Reserve reduced interest rates by half a percent and we expect a total of another one half percent reduction over the next year to help keep the economy moving forward.

Our view of the Financial Markets

The third quarter was a great time for an extended vacation. By traveling away from your TV from mid-July to late September you would have missed the entire 10% equity

correction and subsequent rebound and been no worse for the wear.

The credit crunch we feared would disrupt markets as it spread beyond the subprime mortgage area created breathtaking volatility. Taking the long-term view of equity ownership, we maintained our positions as we believed the equity market was not overvalued early this summer and should therefore be expected to recover from any short-term correction. World equity markets are all performing well as the world economy remains strong. The U.S. equity market remains on track to deliver the 9-12% returns we suggested in our last letter. We have added further international exposure in Europe and Asia through newly issued Vanguard Exchange Traded Funds (ETF's).

The fixed income markets are slowly recovering from the most dramatic seize up in decades. Our auto finance bonds with long maturities were hard hit but we expect them to pay their interest and achieve the good returns to maturity we bargained for originally.

Most Respected Companies 2007

Barron's editor Michael Santoli wrote the 2007 version of *Barron's* "100 Most Respected Companies" and invited Harbor to again participate. Harbor's top selection for 2007 was Berkshire Hathaway as we have long been a Buffett admirer. It turns out the consensus of participants also picked Berkshire as number one. You will be happy to hear that other Harbor holdings fared well as 7 of the top 10 selections are held by many Harbor clients.

The top 10 included the following Harbor holdings:

Berkshire Hathaway
Johnson & Johnson
Proctor and Gamble
General Electric
Microsoft
Cisco Systems
Coca Cola

Harbor was pleased to be invited to participate in this second annual edition of "Most Respected" and if you would like to read the full text of the article it is available through *Barron's* online.

Rant

The Federal Reserve really blew it by not noticing the magnitude of the problem in non-conventional mortgage products sold through -mostly non-bank entities such as brokers. Curtailing ridiculous products such as Option ARM mortgages and Liar loans would have slowed the appreciation in the real estate markets in 2004 and 2005 and would have broadly reduced the foreclosure problems plaguing the mortgage markets today. We are generally of a free market persuasion but this is a case where better government regulation would have been good for all of us.

Rave

Nod to the ubiquitous disclaimer:

While we are not infrequently, and always quite accurately, accused of being of strong opinion...we want to let the reader know we've been wrong before...will be again and please don't hold it against us. The forward looking parts of the letter are the best educated efforts of fallible humans here at Harbor.

When is it okay to rave in a blatantly self-promotional way? When Harbor's Chief Investment Officer, Jack De Gan, appeared for the 6th time this year on CNBC's highly acclaimed Squawk Box program. Jack's interviews will all be available on our soon-to-be revamped website in about a month's time. We are pleased and proud to have Jack's input sought after by one of the most respected financial news organizations. We will worry if he begins to appear on Oprah.

Safe Harbor during Global Warming

Most of our clientele come to us from existing clients or professionals who know our work. If you know of a family who is seeking counsel and might appreciate personalized and attentive financial advice from an independent firm we would welcome the opportunity to serve. If Harbor can serve as a resource on how to find professional guidance other than our services we would be delighted to help with that as well. Give us a call.

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