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* – We expect the US economy to remain in the deepest recession since the 1930's…
- *Our View of the Financial Markets* – The bottom for equity prices could happen significantly below…
- *Confidence in Financial Institutions* – "How could this possibly have happened?"

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."

THOUGHTS ON THE ECONOMY

The U.S. economy continues to slide deeper into recession as the credit crisis weighs on consumers and businesses. We now know 2.6 million jobs were lost in 2008 and we expect a larger number will be lost in 2009 as businesses resize their workforces to a lower level of consumer and business spending. The deleveraging process continues as individuals raise their savings rate and reduce debt. Financial institutions are selling assets and raising capital to fill massive holes in their balance sheets left in the wake of financial asset price declines. We expect the U.S. economy to remain in the deepest recession since the 1930's for all of 2009 with 2010 being a transition year of slow growth setting the stage for resumption of more normal growth in 2011.

The Federal Reserve and the Treasury continue to roll out new programs to fight the credit crisis with modest results so far. Of the three major sources of capital to the economy, banks, capital markets and government, only the government is actually increasing available credit. Banks are extending less credit as the quality of the loans currently on their books declines rapidly. The capital markets remain nearly closed to all but the highest quality institutional borrowers.

The U.S. economy is a credit based economy and simply cannot function without the free flow of credit. There is much debate about the uses of the $700 billion congress allocated to the TARP (troubled asset recovery program). The funds have been 50% committed without a dollar going to the purchase of troubled assets. Instead capital was injected into financial institutions through the purchase of senior preferred equity. The credit problems started with the deterioration in the value of residential real estate and the decrease in value of all the mortgage debt and its derivatives tied to the real estate. We need to stabilize the value of these real estate assets which can be done by lowering financing costs. The government must continue to try to lower the cost of mortgage financing. This would make real estate more affordable and therefore stimulate demand and thereby help stabilize the price.

Until we succeed in stabilizing the financial system we cannot expect the economy to create jobs and allow corporate earnings to grow.

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We provide a safe harbor for individuals and families in New England …

Most of Harbor Advisory's new clients come through referrals from our existing clients or from industry professionals who know us and how we work.

All of us at Harbor Advisory value these referrals as the greatest compliment our small, independent firm could receive.

If you know an individual or family who is seeking counsel and might appreciate sound, personalized investment advise and financial services we would welcome the opportunity to meet with them.

OUR VIEW OF THE FINANCIAL MARKETS

We remain in capital preservation mode after having become more defensive last year. The investment grade corporate bonds and Treasury Inflation Protected Notes we purchased last fall have performed well preserving principal, increasing income and adding price stability to client portfolios. Our reduced equity exposure makes more sense by the day as the economy weakens, corporate profits decline and dividends are reduced. We will continue to add to our fixed income holdings as we monitor credit conditions and the corporate profit outlook for clues to the future course of stock prices. We believe share prices should discount the full extent of this economic recession some time this year and bottom some months before recovery begins. The bottom for equity prices could happen significantly below current levels which accounts for our defensive posture.

We would like to be more optimistic but until we see concrete signs the policy measures designed to pull us out of this situation are actually beginning to be effective, we must continue to maintain preservation of principal as our top priority.

TAX REVISIONS

The change of the calendar to 2009 brings with it a number of tax law changes which carry planning opportunities.

From an estate tax planning perspective the Unified Credit increased from \$2.0 million to \$3.5 million this year. The new administration must address estate taxes this year as next year they are scheduled to be repealed. The annual exclusion gift rises from \$12,000 per person per year to \$13,000. 401(k) elective deferrals increase to \$16,500 for 2009.

The required minimum distribution rate for IRA's, etc. is temporarily suspended for 2009. That means anyone who is over 70 ½ years old and is subject to taking mandatory distributions from their IRA can elect not to take those distributions this year.

MORTGAGE RATES

The government effort to reduce mortgage rates is working and conforming 30 year fixed mortgage rates are currently 5% and could go lower. This presents another great refinancing opportunity for clients who are paying higher rates.

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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.

CONFIDENCE IN FINANCAL INSTITUTIONS

The past year of business *headlines* included a torrent of stories of perfidy and negligence in our financial instituitons and gross violations of personal trust by individuals that run these firms. From enormous bonuses granted to employees of banks receiving tax payer assistance to Ponzi schemes of mind boggling proportions … Harbor employees and clients alike have had more than a few “How could this possibly have happened?” moments.

A senate banking committee panel investigating the Madoff Ponzi scheme scandal recommended that regulations require that client assets at investment advisors be held by independent custodians with non affiliated trading operations and be audited annually by certified public accountants.

Importantly we would like our clients to know that we agree most emphatically with all these recommendations. For over 36 years since our founding we have ***always*** used independent custodians to hold client investments, trade and clearing operations have ***never been*** affiliated with Harbor and we have been audited ***every year*** by an independent CPA firm.

As responsible overseers of our clients' financial wellbeing and safety we have ***always*** seen these arrangements as necessary and a natural part of our advisory jobs.