

# THE HARBOR ADVISOR

## Building Strategic Alliances

The majority of countries and their citizens around the world continue to experience political, investment and economic circumstances that are different than what we are used to; in the first quarter newsletter I referred to this as uncharted territory. I also suggested questioning long standing investment assumptions such as buy and hold, buy on the dips and the market will always recover, in that I think these assumptions will not serve us well in these new and different times. Uncertainty and a lack of experience with any new territory can bring anxiety and even fear. I think it can also bring new opportunities, new ideas, excitement and the confidence that will come from learning a new way to accomplish your goals.

I believe an examination of one's strengths and weaknesses with the tools available to you, including technological, analytical and communicative is appropriate. Given this can be an overwhelming time, asking for help and forming alliances can also help in the process of sifting through ideas, thinking creatively and broadening your intellectual horizons. Alliances can come in many forms: friends, family, and neighbors can all form small groups with similar interests. This process works for education (volunteering for our schools), health care issues (support groups), politics (supporting candidates' causes), conservation (biking to work) and investments.

Harbor would like to be of help; we too are a small group with ideas to share. We also share similar interests in many areas with those we serve. We hope to continue to disseminate ideas through our newsletter, website, quarterly letters and reporting. In addition, we are adding small group gatherings later this year in the areas of investing, charitable issues, socially conscious investing, asset protection, educating your children, private equity opportunities and concentrated sessions regarding assets currently in your portfolio.

We trust that sharing information will be educational, informative and fun. If it relieves some anxiety in the reassurance that you are not alone out there, so much the better.

Enjoy your summer!

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## THEN & NOW

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## Second Quarter 2008 Market Recap

The second quarter of 2008 started on an upswing and ended with the ominous growl of a bear market. A brief recovery in April and May reversed sharply in June with the steady rise of oil prices and the ongoing credit crisis hitting consumers where it hurts. Once again, financials led the downturn across the broad markets with the DJ Wilshire Bank Index down almost 26%. For the quarter, the S&P 500 returned -3.2%, Nasdaq 0.6%, Wilshire 5000 -1.9%, Russell 2000 0.2% and MSCI EAFE -3.5%. Inflation continued to march higher, leading the Federal Reserve to leave interest rates unchanged for the first time since September.

We have continued to act defensively during this bear market (typically viewed as a 20% decline from a recent market peak) by searching for the best absolute returns, expanding private equity, and hedging against market losses. For the second half of the year, we anticipate near-term losses and continued volatility. Detailed notes from the most recent Investment Committee meeting are available on our website: <http://www.harborfin.com>

*Harbor has once again been named to Wealth Manager Magazine's list of the top wealth advisors in the nation!*

### *Fund Focus: The Fairholme Fund (FAIRX)*

At its core, active investing dictates that a diligent and forward-thinking investor should concentrate on the absolute best values available. Warren Buffett has successfully advocated this for over 40 years through Berkshire Hathaway and his value investing philosophy has clearly influenced the manager of this quarter's *Fund Focus* choice.

Classified as a non-diversified large cap blend fund, The Fairholme Fund currently only holds 19 positions. This has the effect of minimizing the influence of the law of large numbers<sup>1</sup> on the fund's returns and reduces correlation to the broader market; valuable attributes for a fund that aims to "ignore the crowd". Manager Bruce Berkowitz has proven his mettle since Fairholme's inception in 1999 by sticking to a long-term value strategy and the fund consistently ranks highly among its peers in any market cycle. Based on his performance, Berkowitz has been mentioned as a possible successor to Buffett when the time comes. Somewhat unsurprisingly, 16% of the fund is comprised of Berkshire Hathaway shares<sup>2</sup>.

<sup>1</sup> This states that the average of observed values will approach the expected value as the number of observations increases.

<sup>2</sup> [www.fairholmefunds.com](http://www.fairholmefunds.com), 03/31/08

## Maximizing Yield

At Harbor we view cash as an asset class. In addition to its obvious uses for liquidity it provides stability for the portfolio. Given the recent decreases in money market yields, we have been searching for assets with superior yields without adding inordinate amounts of risk. We favor short-term tax free municipal and taxable bond funds that offer similar qualities to money market instruments, but typically provide superior yields with slightly longer duration. Short-term tax free bond funds are comprised of short-term municipal debt obligations that pay a tax-free income stream. Taxable bond funds invest in short-term corporate and treasury notes. Additionally, neither of our picks, the Vanguard Short-Term Tax Exempt Fund (VWSTX) and Vanguard Short-Term Bond Index (VBISX), purchase debt obligations that carry AMT consequences for the applicable investors. Also of note, since these funds are invested in short-term paper, if yields rise these funds will be some of the first to benefit.

Let's consider the following scenarios for taxable versus tax free funds:

An investor is holding \$100,000 in cash and expects he or she will continue to do so without any major cash demands in the future. Current yields for money markets held with Schwab are 2.36%<sup>1</sup> – resulting in \$2,360 a year in ordinary income. Also suppose this investor is in a 35% tax bracket, then the resulting tax would be \$826, netting \$1,534 in after tax income.

Now suppose the same investor holds the \$100,000 in the aforementioned tax exempt bond fund. VWSTX yields 3.36%<sup>2</sup> = \$3,360 per year in after tax income. A difference of \$1,826 more per year!

For IRAs and other non-taxable accounts, the approach varies a bit since it is unnecessary to hold tax exempt positions in qualified accounts. In these scenarios the investor can use taxable short-term bond index funds that offer a higher yield. Consider the previous example of \$100,000 in a money market netting \$2,360 a year. Compare this to the Vanguard Short – Term Bond Index Fund currently yielding 4.37%<sup>2</sup> a year. This yield would produce \$4,370 in net income which would deliver an additional \$2,010 per year.

Holding short-term bond funds can be a strategic alternative to holding reserves of cash. Please give us a call to further discuss implementing these bond fund strategies in your portfolio.

<sup>1</sup>As of 05/30/08. Accounts held at Schwab Institutional.

<sup>2</sup>As of 4/30/2008

## Charitable Planning

For decades, people around the world have donated their time and money to charitable and philanthropic organizations. The words build, preserve and endow epitomize the spirit of wealth management and the progression of wealth for many families.

Charitable giving is playing an increasing role in the overall financial and investment picture for individuals. Approximately \$295 billion is donated annually in the U.S. and 76% of that or \$222 billion per year comes from individual donors.<sup>1</sup> Like many other aspects of their overall financial and investment picture, these philanthropic individuals are seeking advice on how to best incorporate their charitable efforts into their financial goals.

The current tax code encourages giving as well as longer-term strategic charitable gift planning. Ideal opportunities are a liquidation of a significant asset, for example a privately-held business, initial public offering, a significant bonus or incentive compensation. This can be matched with a deduction in the same year the liquidity event occurs. You can also set up a vehicle that will support giving over multiple years. Another strategy is to fund the charitable trust with an appreciated asset. This avoids the capital gains tax on sale and accomplishes the charitable gift at the same time.

There are a number of ways to gift:

**Direct gifts** - Of cash, tangible personal property or securities

**Endowment-Style Giving Vehicles** - Donor-advised funds, Private Foundations, Community Foundations

**Income-Producing Gifts** - Charitable Trusts, (CRT, CLT) Gift Annuities and Pooled-income funds

There are many tax, legal and planning considerations involved in the set up and maintenance of charitable vehicles. Each situation needs to be researched with the individual's goals and resources in mind. We have researched private foundations, community foundations, donor advised funds and can help with direct contributions. We are also available to help you determine what role charitable gifts should play in your and your family's financial plan.

<sup>1</sup>Giving USA Foundation's Annual Report on Philanthropy for the Year 2007.



## Schwab Advantages

We have now completed the transfer of most of our accounts to Schwab Institutional and would like to highlight some of the advantages now available to you. First on our list is the ability to receive the monthly statements, shareholder materials such as prospectuses and proxies and trade confirmations online. This service includes a ten year archiving of the electronic documents on the Schwab web site. Another highlight of the web site includes the "At a Glance" page with account summaries and real time quotes for indexes, stock and mutual fund positions.

Another advantage at Schwab is lower trading costs and fees. Some mutual funds have zero transaction fees and even the highest mutual fund trading cost is significantly lower than what we were previously paying, as are the equity trading costs. You can further lower your equity trading costs by signing up online for electronic notification of your trade confirmations. There is also no annual maintenance fee for IRAs held at Schwab.

Last, we love the ease of moving funds from account to account at Schwab as well as to your local bank account. We feel this allows us to serve your needs more quickly and with less inconvenience to you.

## Living Well

Have you visited the Boulder Farmers Market yet this year? It is open Saturdays 8am - 2pm and Wednesdays 4pm - 8pm in downtown Boulder.

We wanted to share a couple of our favorite vendors with you:

**FLOWERS** – Pastures of Plenty from Longmont offers locally-grown, fresh cut organic flowers and spectacular hanging baskets.

**CHEESE** – Windsor Dairy offers a nice variety of quality cheeses made with 100% organic milk from their grassfed cattle. Try the Colona or the Jack!

**PASTRIES** – Brillig Works has wonderful cinnamon rolls and lemon curd scones. Enjoy one while wandering the market and take extras home for later.

**DUMPLINGS** – Sister's Pantry offers fresh, hot dumplings (the Chicken with Fresh Thai Basil Dumplings are terrific). You can purchase them already cooked or frozen to take home and enjoy.

## Living Smart

Your credit score plays an important role in determining the interest you pay on your mortgage, car loan, credit cards and auto and homeowners insurance.

The following chart demonstrates how much your score can affect a mortgage loan rate:

\*FICO Score      15-yr home equity loan rate

760-850	5.829%
700-759	6.051%
660-699	6.335%
620-659	7.145%
580-619	9.312%
500-579	10.276%

You can improve your credit score by correcting any errors on your credit report, paying your bills on time and paying off your credit cards every month. Another way to improve your score is to leave old paid-off accounts open.

\*<http://www.myfico.com>, May 29, 2008.

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# Harbor Financial Group

Images: David Lat

## Harbor Happenings

### HARBOR'S NEW OFFICE

We are officially in our new office. If you haven't had a chance to come by and visit, we'd love to have you stop by sometime – 1909 26th Street Suite 1A – plenty of parking too! Please call if you need help with directions, which are also available on our website.

### SUMMER INTERN

We are happy to welcome Megan Foster as our summer intern once again. Megan just completed her second year at the University of San Diego. She will be responsible for general client contact and maintenance, research, individual stock tracking, surveys and numerous special projects.

### HARBOR SEMINARS/EVENTS

Is there a particular topic that you'd be interested in learning more about? We'd like to hear your ideas as we are planning to host a number of events later this year. Give Denise a call or email her at denise@harborfin.com.

### TO WHOM DO I MAKE MY CHECK PAYABLE?

- Checks for deposit to your Schwab account should be made payable to Schwab Institutional with your account number notated.
- Checks for payment of your wealth management planning services should be made payable to Harbor Financial Group, Inc.

## 2008 Closures

The New York Stock Exchange (and therefore our office) will be closed on the following days in 2008: Labor Day—September 1, Thanksgiving Day—November 27, Christmas—December 25.

Securities offered through Triad Advisors and Schwab Institutional. Members FINRA & SIPC.

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