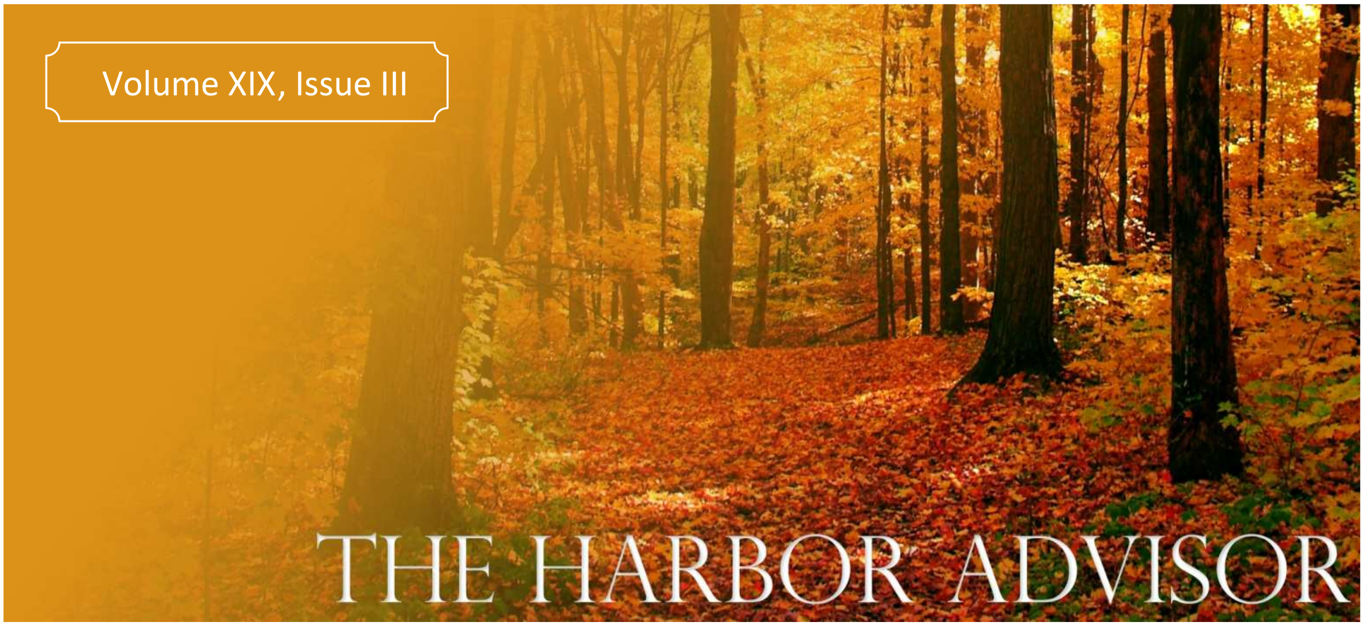


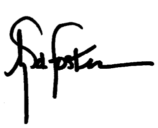
A Global Perspective

I believe traveling has a myriad of benefits, for me the change of scene promotes creativity; getting away from the familiar is personally expanding, and leaving the hectic schedule most of us live with is relaxing. Having just returned from several weeks in the UK and Ireland the change in perspective was more noticeable than usual. I believe this is due to the global economic situation and the upcoming US election. We spent time in London, Cornwall, Scotland and Ireland. While everyone we met was keenly aware of the economic, world trade and currency issues and US election news, it was the Irish who engaged us in the most spirited discussions.

The Europeans we spoke to are keenly aware of the symbiotic nature of the world, the effects we all have on global economics, ecology, and the role that politics play in these processes. Discussions at pubs, historic sites and hotels were interesting and informative. The people we spoke with were quickly political; had an opinion and were eager to discuss economics, currency rates and the American political scene. I wondered more than once if Americans are as aware of this increasing global interdependence.

European citizens are coping with steep price inflation for food and consumer goods, energy prices historically much higher than ours and high taxes. They are understandably concerned. The Lehman announcement and subsequent government bailout proposal occurred during my last week in England. The full impact of these events will likely not be felt for months, if not years.

We at Harbor have increased our frequency of market overviews. Of most import is to look frequently and make few moves. We welcome your questions and opinion about the financial situation we find ourselves embroiled in. Effective communication remains the key to effective asset management during these trying times.



October 24, 2008

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THEN & NOW

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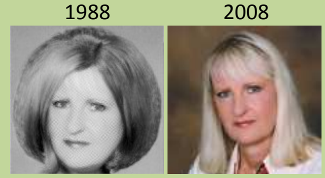

Third Quarter 2008 Market Recap

Credit conditions continued to worsen and subprime mortgage exposure dominated the headlines. Freddie Mac and Fannie Mae's subprime exposure forced a government bailout. Highly leveraged exposure to these assets and other risky derivative investments forced Lehman Brothers into bankruptcy protection. Merrill Lynch & Co was purchased at a fire sale price by Bank of America. American International Group was given an $85 billion lifeline as the government is now its largest shareholder. Washington Mutual couldn't survive either and a run on customer deposits caused the feds to seize control of the bank and auction off pieces of the company. In a FDIC backed sale, Wachovia was acquired by Citigroup, with the counter offer from Wells Fargo still in legal proceedings. Investment banking as we know it is effectively over as Goldman Sachs and Morgan Stanley converted their business model to commercial banks.

Trading patterns were extremely volatile as investors' fears mounted over the financial solvency of all industries, financials in particular. We witnessed the worst single day point drop in the DJIA when it moved 777.7 points lower in response to the House of Representatives rejecting the first draft of the $700 billion bailout package. The commodities bubble burst with fears of a global recession. International markets faced more severe sell offs with export based emerging markets facing the worst losses.

For the quarter the S & P was off 9%, NASDAQ -9.2%, Wilshire 5000 -9.16%, Russell 2000 -1.46% and MSCI EAFI -21.05%. Market volatility continues into the fourth quarter and this could continue well into 2009.

"To conquer fear is the beginning of wisdom." - Bertrand Russel

Strategic Allocation Strategies

Beyond the broad choices of a large cap value fund or an international bond fund, Harbor dedicates a significant portion of its portfolio analysis to determining specific sectors and strategies that supplement our more traditional investment choices.

Sector allocation focuses on distinct sectors of the market to invest in based on value and opportunity. If commodities are subject to a future increase in demand, then an increase in the allocation to that sector can capture a higher overall return. It is also important to avoid overheated sectors ready for a market correction. Some examples of the sectors we monitor are energy, commodities, technology, real estate, health care and financials.

Tweaking allocations to a certain sector is one thing, but what about wider investment issues? What options are available for investors concerned with inflation, volatility or currency risk? In this case, we turn to alternative strategies, such as long/short, conservative allocation, real return and hedging. Long/short funds purchase assets predicted to increase in value and short assets predicted to decrease in value. Conservative allocation funds aim to weather any economic conditions with minimal losses by investing in a mix of relatively safe investments. Permanent Portfolio (see accompanying article) is typical of this style. Real return funds protect against inflation by investing in inflation-indexed securities while attempting to match market returns. A fund using a hedging strategy attempts to eliminate as much market risk as necessary through the use of options and futures contracts. Hussman Strategic Growth is a prime example of a defensive hedging fund. Currency hedging adjusts for changes in currency rates to stabilize a return. An example for US investors would be an international fund that traded foreign companies utilizing a local currency. To counteract the impact of currency rates unduly affecting returns, the fund can choose to hedge against the currency to isolate only the corporate returns. Pimco Developing Local Markets follows this strategy.

Many of the above alternative strategies will lag the major indices in a rising market due to their low correlation, but their true value is to provide a cushion in a down market. By allocating a substantial percentage for these strategies in your portfolio, it is possible to reduce losses, decrease volatility and retain value in difficult markets. Losing 10% and then gaining 10% on what is left is far worse for your portfolio than losing 5% and then gaining 5%.

Fund Focus: Permanent Portfolio (PRPFX)

We turn our attention to Permanent Portfolio for this quarter's fund focus. Permanent Portfolio (PRPFX) is a diversified fund focusing its holdings on six major categories: Gold, Silver, Swiss Francs, International Real Estate and Natural Resource stocks, Aggressive Growth stocks, and US Treasury Bills & other Fixed Income securities. This composition fares well in diverse market conditions as the low-correlation of the portfolio's holdings helps to decrease the impact of any negative events. Its performance illustrates just that: it has only posted a negative return in three years since its inception in December 1982. Current year returns hold to this principle with a YTD return of -1.61% through 09/30/2008 compared to the Wilshire 5000 being down 19.87%. Plus, this fund proves useful for investors of all types as its low minimums gives access to wide diversification. In bull markets such a moderate allocation may lower the overall return, but proves invaluable when markets turn sour. As a core holding providing steady purchasing power and growth, we are happy using this fund in the long-term. For more information on how Permanent Portfolio fits into your portfolio, give us a call at 303-939-8788.

Asset Protection

This article was originally intended to explore asset protection strategies, specifically the use of asset protection trusts to protect assets in the event of bankruptcy, divorce and law suits. Given the recent market events I think the discussion should be expanded to include other kinds of asset protection. Concern about retirement savings, education funds for children and grandchildren, the safety of cash, the strength of insurance companies and brokerage firms, as well as the status of health insurance, life insurance and annuities are all currently on our minds.

Rather than be paralyzed by uncertainty and even fear I have compiled a list of what you can do now in a strategic and proactive way to regain a measure of control over your financial life. A more comprehensive version of this letter will be available on our website www.harborfin.com.

In more stable economic environments the focus can be on the creation of asset protection trusts. These trusts are used to protect assets against legal claims from others. They can be structured to allow for the maximum control of the assets on the part of the beneficiary. Estate plans can include these kinds of trusts for your children or spouse. Q-Tip trusts have been used for years to protect assets passed to your spouse from a new spouse in remarriage thus preserving your assets for your spouse and children.

Currently, the protection of your cash deposits both brokerage and bank has become a concern. Also of concern is the insurance protection on your stock and bonds. Insurance companies are in existence to protect assets such as your home, car, earnings, liability and life. Since the solvency of insurance companies has come into question, they need to be examined too. Assets set aside for education and retirement need to be reviewed as well. Will the value of these assets be there when you need them?

In addition Harbor can be of help in determining just how safe your assets are and ways you can shore up your protection if need be.

Schwab Asset Protection – An Example

We recently sent a letter detailing the insurance coverage for our Schwab brokerage accounts. This insurance includes both the SIPC coverage (up to $100,000 for cash and up to $500,000 for each account) and Schwab's additional coverage through Lloyd's of London (up to $1 mil. for cash and $150 mil. for combined client accounts). Please note that money market funds are covered by the security insurance amounts.

The following scenario demonstrates the insurance coverage for a Schwab brokerage account with $850,000 in cash and $10 million in securities.

$100,000 of cash covered by SIPC
$750,000 of cash covered by Lloyd's of London
$400,000 of securities covered by SIPC
$9,600,000 of securities covered by Lloyd's of London

Please do not hesitate to phone or email the office if you have any questions about the insurance coverage on your brokerage accounts.

Living Well

Here are some simple tips you can use on your next vacation to give the planet some much needed R&R too.

1. Go paperless with your PDA by downloading travel guides & maps.
2. Pack Light – Even 10 extra pounds per passenger translates into the need for extra fuel, which can then lead to more carbon dioxide emissions.
3. Reuse Towels/Sheets – Hang your used towels to dry and reuse before tossing on the floor. Leave a note for housekeeping to skip changing the sheets and towels. This can save up to 30 gallons of water per day!
4. Eat Locally – Minimize food-transport pollution by choosing a restaurant that uses local ingredients.
5. Drink Locally – If the tap water is safe, drink it. Discarded plastic bottles can take years to biodegrade.

Living Smart

As part of the financial planning process, we ask clients to provide monthly benefit amounts reported on their Social Security Statements. Although Social Security benefits may be taken as early as age 62, benefits are reduced if taken before normal retirement age, which ranges from 65 through 67. In some situations, such as for health considerations, taking benefits early makes sense. However, we generally recommend waiting until normal retirement age.

The impact of taking benefits early becomes substantial in the long-term. Assume you were born in 1950, your normal retirement age is 66 based on Social Security charts[1]. If your full monthly benefit were $2,500 per month, it would be reduced to 75.42%, or $1,885 if you begin drawing benefits at age 62. Adjusting for an estimated 1.50% annual Social Security inflation factor, your total normal retirement benefits would exceed your total early retirement benefits at age 76. By age 95, you would collect an additional $200,000 in benefits by waiting until normal retirement age.

[1]www.ssa.gov

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Harbor
Financial Group

Images: Nat Arnett

Harbor Happenings

20th ANNIVERSARY CELEBRATION

We enjoyed seeing those of you who attended Harbor's 20th Anniversary party in July – it was a fun evening. Stay tuned for future client events!

INTERNS

In August, we said goodbye to our summer intern, Megan Foster. She has gone abroad to study in Ireland for a semester before returning to the University of San Diego where she is a junior. She has been a tremendous asset to our office and will be missed. Subsequently, we have hired Megan Whittlesey to intern with us for this next year. Megan is currently a senior at the University of Colorado at Boulder double majoring in Business and Political Science. We are excited to have her as part of our team.

TELL A FRIEND

Do you have a friend, family member or co-worker who would be interested in receiving our quarterly newsletter? If so, let us know and we'll be happy to put them on our email distribution list.

2008 Closures

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

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