# HarborView Capital Management LLC

## Global Investment Advisors

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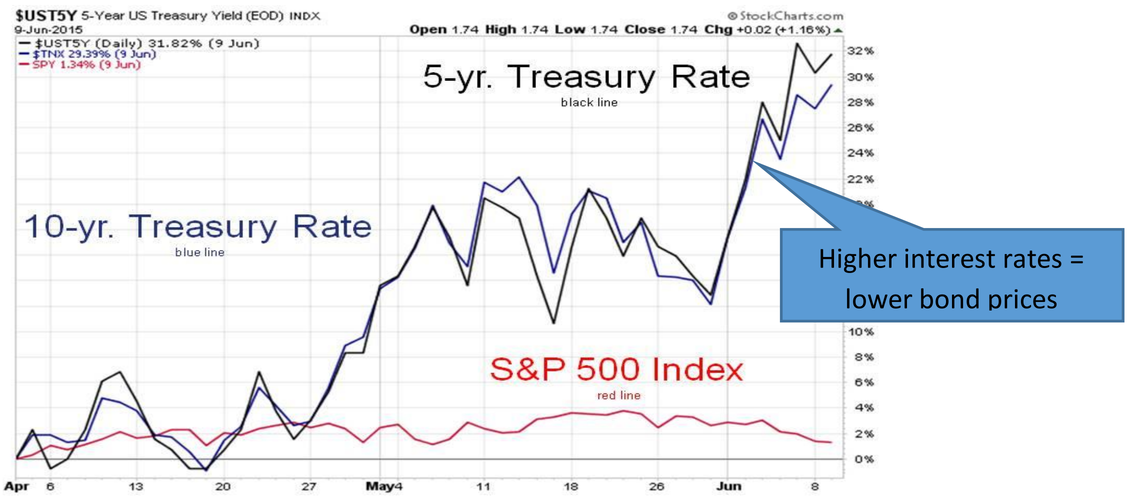
**Investor Letter** **July 6, 2015**

Looking at the market returns thru the end of the 2nd quarter one could be forgiven thinking not much happened the 1st six months of 2015. U.S. stocks are flattish, and bond prices are down (in some cases significantly) as our Federal Reserve seems poised to begin tightening interest rates after 6 years. Foreign stock markets are generally up for 2015 but gave back much of their gains due to the ongoing Greek drama (more on that below) and the Chinese equity market meltdown in since June (a 30%+ decline).




Gold is down a bit, oil up 10% or so after 2014's major decline and the US$ is generally stronger, having extended its move higher from the 2nd half of 2014. (Please see the chart on page 4 for a rundown of various markets performance.)

For the FED and the markets there are many crosscurrents, which is nothing new. Much like recent years the U. S. economy had another weak (ie flat) 1st quarter GDP which will be followed by ~3% growth in the 2nd quarter. Earnings for the 1st quarter where expected to decline (mainly due to declining energy sector earnings) but were actually up 1.6% YOY. The bar is rather low for 2nd quarter earnings as well, which start next week. For the remainder of 2015 the expectation is for positive YOY earnings growth. We agree.

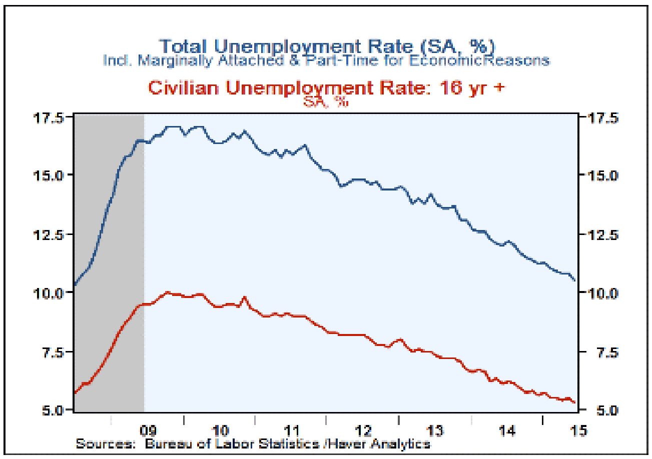
As you know from reading our past letters it is recessions that create bear markets in stocks. The S&P500 declines 30%+ when our economy goes into recession. Recessions are not officially recognized as such until after the fact. As we see it one of our main jobs managing your savings is to identify a recession before it occurs and make the appropriate reallocations in client accounts. Protection of principal is key to meeting any investment objective.

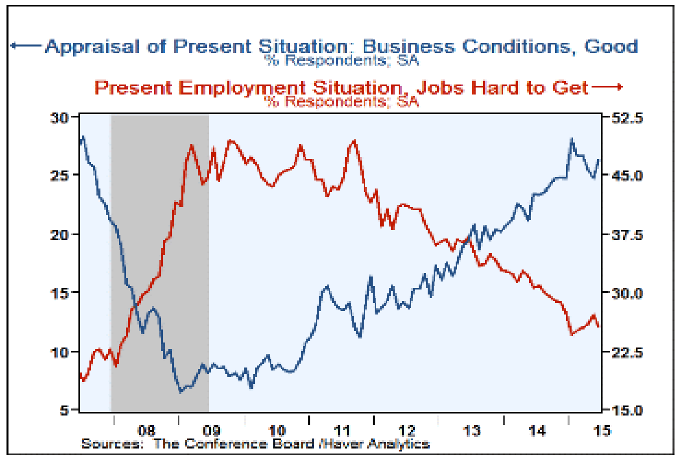
The good news is many economic indicators look more like early stage recovery "type" numbers, while the "recovery" such as it is approaches its 7th birthday. We can posit many reasons for this – the depth of the 2008/09 recession, burdensome local & Federal government debt levels, baby boomers leaving the workforce, the X generation not contributing, as normal, to household formation (with student loans being a major culprit), uncertainty in the regulatory & tax situation, historically low interest rates (undermining savers thereby forcing them to save even more), cheap money keeping unproductive (ie zombie) companies from failing, continued gridlock in Washington. Suppose we could go on but you get the point.

These are all reasons for the tepid top line corporate revenue growth we have post 2008, while bottom line earnings are being “goosed” thru financial engineering (buybacks/dividends/M&A) which itself is fueled by cheap money. One might say that “buybacks = corporate QE”…or said another way the FED’s low interest rate policy runs deep.

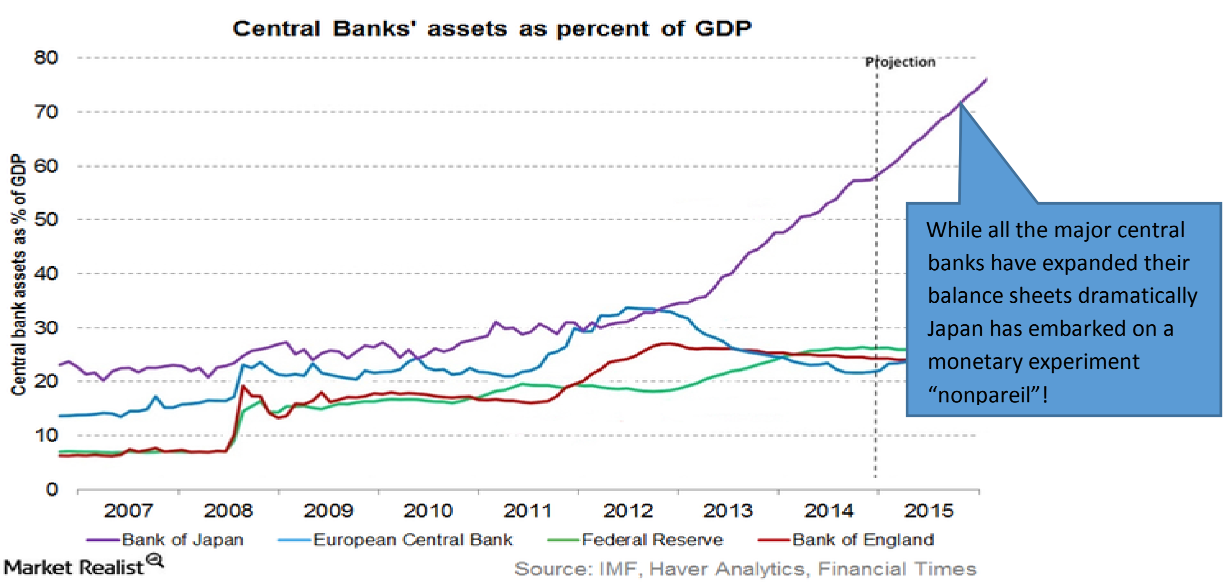
There is good news, and this is what keeps us bullish on risk into 2016. While the FED may begin tightening in 2015 they will be data dependent and the path to normalization will be slow. The FED has some “cover” to do so because inflation, and inflation expectations, remain low even as the labor markets continue to exhibit robust growth. Recall that the FED has two mandates from Congress 1) price stability (which the FED defines as ~2% core inflation) and full employment.

One can argue about the quality of jobs created but one can also argue there are plenty of good paying jobs going unfilled because our educational system is not generating enough labor market participants with the needed skill sets. This is a structural problem and not one the FED thru monetary policy is likely to influence greatly.




We are concerned about the lack of inflation. We are also concerned about the size of the FED’s balance sheet and the potential for the reserves held in our banking system to be unleashed, potentially creating uncontrolled inflation that the FED would be forced to address thru monetary policy. The two handed economist is alive and well these days! In the chart below one can see our FED is not alone in expanding its balance sheet.



For now we have a relatively benign interest rate environment domestically with monetary easing taking place in the majority of the developed countries and China. Inflation remains benign as well globally, though deflation OR inflation could threaten in the future. Equity valuations globally are favorable, while domestically the broad market is closer to “fair value” but certainly not overvalued. The fact that the move higher in stocks since March 2009 remains the most “unloved” bull market in history suggest sentiment is still not bullish, much less euphoric, and cash levels are high. Perhaps most importantly of all there is no recession on the horizon. Taken together the fundamental picture still looks positive for risk. Now on to Greece…

This past weekend Greece voted “NO” to the referendum on austerity. The Greek people voted not to accept a draft agreement document submitted by the EU/ECB & IMF. This strengthened the Tsipras government’s anti-austerity mandate and now it’s up to the EU (basically Germany) whether or not to keep Greece in the Euro. Greece wants debt forgiveness on their $325bn of debt outstanding, while the Germans don’t want to set a precedent for the other PIIGS nations, mainly Italy, whose debt is ~$2trillion. At the same time the Germans do not want the Greeks to leave to Euro and reestablish the Greek drachma. If successful the Greeks then provide a template for the PIIGS to follow when times get tough again. The Germans are now trying to thread that needle. (We have attached separately a decent outline of what the Greeks may face if they do leave the Euro.)

The vast majority of Greek debt is now held by the ECB and the IMF, whereas 5 years ago 70% was held by European banks. Regardless of how this drama ends the negative effects of any forgiveness of that debt to the European and global economies are unlikely to be severe, while in 2010 it would have caused a meltdown in the European banking system, with obvious repercussions globally. The success of the “stabilization” measures (ie transfers of Greek debit liabilities to the ECB/IMF from the banks) since 2010 one might compare to George W. Bush declaring in 2003 from the deck of the aircraft carrier USS Abraham Lincoln, “Mission Accomplished.”

One indication Greece is now intent to cut a deal however is the resignation today of the Greek finance minister Varoufakis. Varoufakis was major irritant in the negotiations with the Europeans and the IMF. The fact he is gone signals the Greeks want a deal – they also need their banks to reopen, and soon. The IMF today said debt relief is necessary (quelle surprise!), and its clear Angela Merkel, Germany’s Chancellor, wants Greece to stay in the Euro. The next debt payment of $1.7bn is July 20th, to the ECB. The sides seem not too far apart then. We will see.

For now we are watching peripheral European yields. The ECB has effectively “bear hugged” the Italian/Spanish/Portuguese bond markets. Any contagion from the Greek situation would be seen in the form of higher rates in these bond markets. So far so good.

One additional item to note. Our AAA strategy, which forms the “core” of the majority of our client accounts has performed well on a relative basis thus far in 2015, and is up +2.62% for thru the end of June

Please review your portfolio reports, and the chart on the following page with year to date returns for various global investment products. As always if you have any questions or comments please contact us.

We hope everyone has a wonderful summer!

Best Regards,

Paul Brian Gibson, Partner
HarborView Capital Management LLC

| Investment Product | 12/31/14 Close | 6/30/15 Close | 2015 YTD |
|---|---|---|---|
| S&P500 (index) | 2058.90 | 2063.11 | 0.20% |
| DJIA (index) | 17823.07 | 17619.51 | -1.14% |
| NASD (index) | 4736.05 | 4986.87 | 5.30% |
| Total Work Stock Market (VT) | 59.40 | 61.52 | 3.57% |
| Emerging Markets (VWO) | 40.02 | 40.88 | 2.15% |
| Europe (EFA) | 60.84 | 63.49 | 4.36% |
| China (FXI) | 41.62 | 46.10 | 10.76% |
| Japan (EWJ) | 11.24 | 12.81 | 13.97% |
| Brazil (EWZ) | 36.57 | 32.77 | -10.39% |
| Latin America (ILF) | 31.81 | 29.80 | -6.32% |
| Canada (EWC) | 28.86 | 26.67 | -7.59% |
| Barclays Aggregate Bond (AGG) | 110.12 | 108.78 | -1.22% |
| U.S. Dollar (UUP) | 23.97 | 25.03 | 4.42% |
| Oil (WTI spot) | 53.71 | 59.06 | 9.96% |
| Gold (spot) | 1184.02 | 1172.75 | -0.95% |
| AAA Strategy (no fee) | 551.14 | 565.58 | 2.62% |