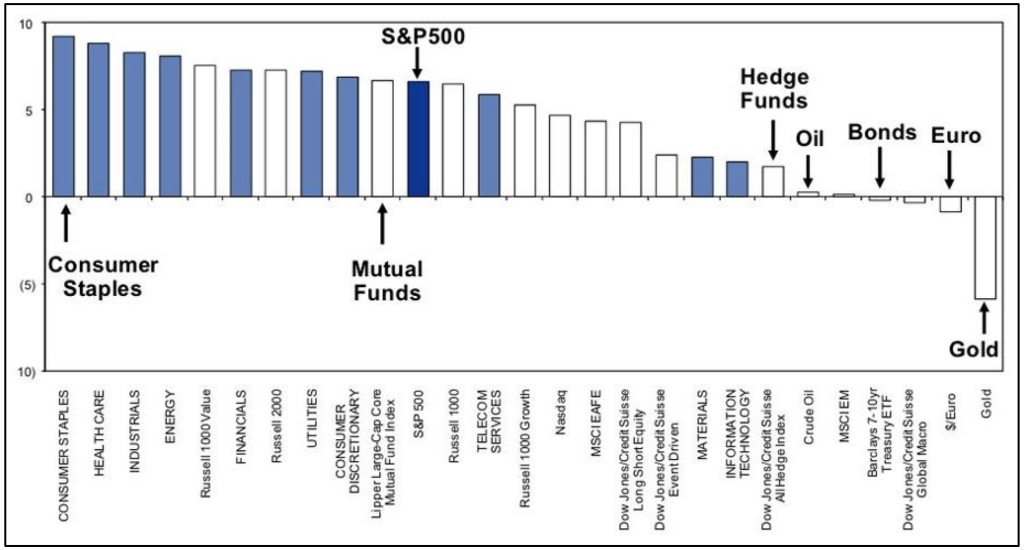
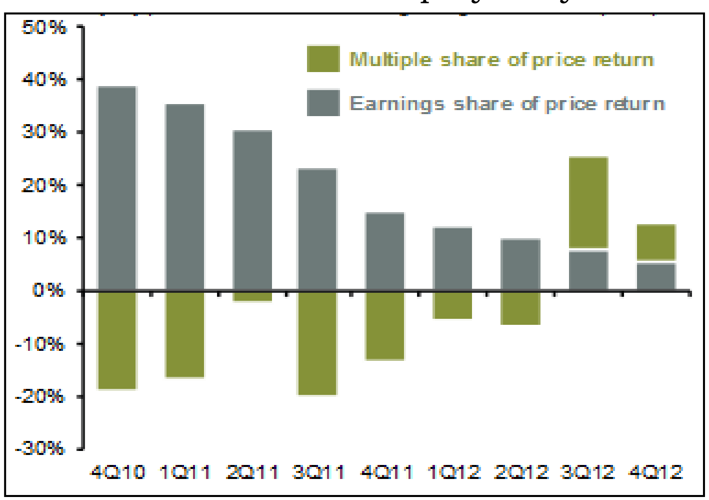
Market Recap

2013 Sector, Style, and Strategy Performance (as of end of February)



Source: Compustat; IDC; MSCI; Goldman Sachs

Contribution to Equity Rally



Source: Factset; Standards & Poor's; J.P. Morgan

The U.S. equity market posted consecutive monthly gains to start the year. The advance has been broad-based, with most U.S. major stock indices at or near historical highs. Investor appetite has been fueled by strong U.S. company earnings, with fourth-quarter profit up an average of 6.9% on revenue growth of 3.5%. Accompanying the rising equity markets has been increased merger and acquisition activity. By mid-quarter, the value of announced U.S. M&A deals exceeded the value of deals brought to market in the first quarter of 2012. This increased activity reflects companies' greater confidence in the economic environment. One notable exception to 2013 performance has been gold. Weakened performance in gold is also a reflection of investors' confidence in the financial climate, as the commodity often declines in price during times of greater certainty and optimism.

With the fourth quarter 2012 earnings season winding down, reported S&P 500 earnings growth has averaged close to 7%. This represents a slowdown over prior quarters. The post-recession rally has been driven by double-digit earnings growth seen over the past few years, rather than by the willingness of investors to pay more for these earnings. Given that we have yet to see such a sentiment-driven rally and multiple expansion, valuations have remained relatively attractive. This is important to keep in mind as the S&P 500 approaches its all-time high. In October 2007, when the S&P 500 was at its historical high, the Price to Earnings ratio (P/E) was 20% higher than it is today. With a modest-but-positive outlook for earnings in 2013, a continued improvement in sentiment and resulting multiple expansion would seem necessary for the market to match the S&P 500 performance of last year.

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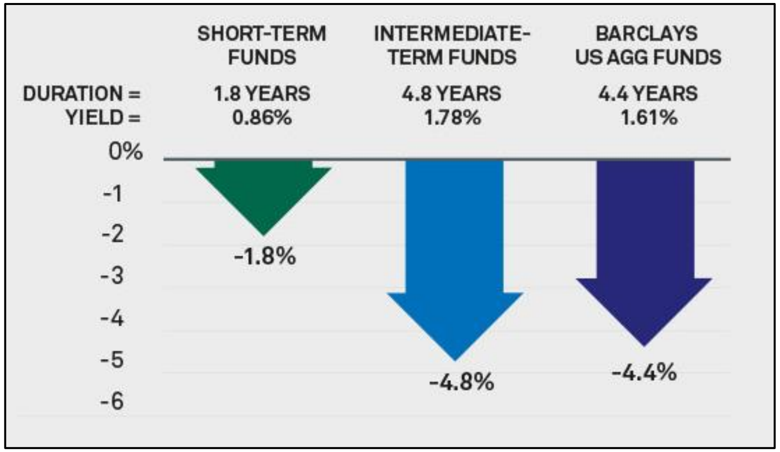
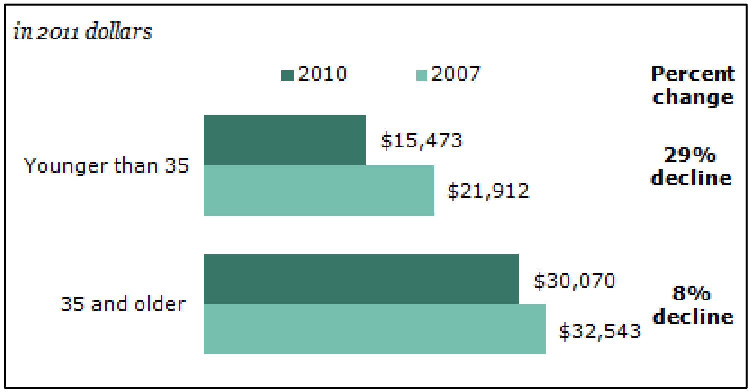
Bond Price Effect of a 1% Increase in Interest Rates



Source: Lipper; Barclays; Blackrock

Over the past 30-year period, a traditional core fixed income portfolio offered average annual returns comparable to stocks—and with lower volatility. Such performance characteristics resulted from this unique period of secularly-declining interest rates. Recent central bank monetary policy has driven interest rates to historically-low levels. Today, the bonds purchased by the Fed as part of quantitative easing drive up prices and drive down yields. Current income yields are well below inflation rates, meaning investors are losing money in real terms. Investors are left with low real income and a very small buffer to protect themselves from the effects of rising interest rates. Improving economic growth is expected to eventually move rates higher. Any interest rate move higher has a high chance of generating negative total returns for bonds, leading to increasing risk faced by traditional fixed income investors.

Median Total Household Debt by Age of Head of Household (2007 vs. 2010)



Source: Pew Research Center

After running up record debt-to-income ratios during the bubble economy of the 2000s, young adults shed substantially more debt than did older adults during the Great Recession and its immediate aftermath. Most of the debt reduction was by virtue of that demographic owning fewer houses and cars. From 2007 to 2010, the median debt of households headed by an adult younger than 35 fell by 29%, compared with a decline of just 8% among households headed by adults ages 35 and older. Further, the share of younger households holding debt of any kind fell to 78%, the lowest level since the government began collecting such data in 1983. These shifts in the debt profile of younger adults also seem to reflect a broader societal shift toward delayed marriage and household formation that has been under way for several decades now.

Contact: If you have any questions or comments, please do not hesitate to contact us at 703.992.6164. For more information about Harbour Capital Advisors, please visit our website at www.harbourcapitaladvisors.com.

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