

Dear Clients and Friends,

As I sit peering out my office window at yet another overcast grey sky and switch on the heater beneath my desk to thaw toes and fingers numb from the bicycle ride into the office, my thoughts have turned to the concept of “too much of a good thing.” Ice, for instance: I surely enjoy the benefit of a few cubes floating in a beverage on scorching hot summer days but am less enamored of it when scraping several inches off the windshield of my truck on frozen mornings and trying to keep bike and rider vertical riding over crusts formed on wet roads. My mind leaps to other subjects to which the phrase applies: Rising stock prices, bond purchases by central banks (a.k.a. quantitative easing), etc. I confess that the phrase also applies at a personal level to “holiday spending” and “wine drinking” but this note will stick to investment-related topics.

As usual, rather than diving straight into a discussion of the economy and markets, we’ll start our quarterly review with an update on a few more mundane items.

Around The Office

We took the opportunity of the approaching year-end to discuss with many clients the structure and performance of their portfolios. We encourage clients who didn’t have time to meet prior to year end to contact us to set up a time for a short review.

As usual we released research on a range of economic and investing topics including our market view, reviews of Boise and Idaho economic statistics and analysis of the never-ending stream of national economic data. Feel free to contact us or visit HarmonicAdvisors.com to review our research.

We expect Harmonic’s internship program to include three students again this spring. Dan Simenc and Neel Gupta have continued their internships from the fall, and we’re currently interviewing for a student to replace Jody Hilliard, who completed his undergraduate work at BSU in December. Dan, Neel and Jody worked on projects that included calculating target prices on stocks owned in client portfolios, building dividend discount and other models to be used to value companies and markets, evaluating hedging strategies to be considered for our private client portfolios, streamlining the spreadsheets that are used in our stock screening process, and contributing to the development of an Idaho stock index. Their help has been very

valuable to us and we appreciate their contribution to continuously improving our research process.

Economic and Market Review and Outlook

The rally that began September 1st 2010 continued its run higher more-or-less uninterrupted through year-end. The Russell 3000, a broad US stock market index, rose +11.6% during 4Q10 and has continued to move higher through the first three weeks of January. Stocks have been the beneficiary of the Fed's initiation of bond purchases known as QE2. Oddly though, Treasury bond prices have fallen during this same period, contradicting what one would expect to be the normal reaction when there's a large and continuous buyer in the market. Investors in US Treasury bonds would certainly agree with the observation at the top of our letter about loss-creating central bank bond purchases being "too much of a good thing".

While the "quality" of the market action is questionable given our belief that the latest round of Fed bond purchases won't much help the economy, stock investors jumped on the proverbial bandwagon as the Russell 3000 stock index continued to roar higher. The uncertainty represented by the election is out of the way, giving the stock market clearer sailing. That the fourth quarter of the year typically has the best performance was also not lost on stock investors. Foreign stocks also benefitted, although the aimless performance of the US\$ hasn't been as great a tailwind for domestic investors as in previous periods. In our view there's a little too much of a good thing, too, when stock prices don't reflect economic realities but are driven by speculation or fear.

While US Treasury bonds were pummeled, corporate and other bonds, commodities and REITs rose along with stocks during the fourth quarter, allowing solid performance for most of our private client portfolios.

We continue to think it's likely that the market "trades sideways" with higher than normal volatility for the next several years, suggesting that investors should become more tactical in their approach rather than pursuing a buy-and-hold strategy.

The economy, despite the recent stock market gains, continues to suffer from malaise. The data released since the quarterly Client Letter affirmed our assessment of slow and uneven growth in the US economy. The data tips the proverbial scales slightly to the positive side but many issues remain that could garrote the recovery.

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In a nutshell, macroeconomic changes during the quarter were marginally positive:

- Consumers remain hunkered down, with spending rising only slowly, unemployment still unacceptably high, debt being repaid (or defaulted on) and housing values seeming to turn down again. Importantly, though, unemployment appears biased downward.
- Large companies seem to be doing well, as many are hoarding cash, resisting hiring and capital spending and reporting very good earnings. However, small businesses continue to struggle, often capital starved due to tight bank lending and the hesitant behavior of the previous two groups.
- The US trade balance improved as exports grew more than imports.
- While we don't believe QE2 will be effective in lowering unemployment we're encouraged by the recently passed fiscal stimulus measures. They're more targeted than monetary stimulus and are more likely, we think, to generate increased economic growth. That said, both forms of stimulus will further balloon the budget deficit, which has grown to alarming levels.

We continue to repeat our steady refrain of the past 2 years: The developed economies' malaise is a debt-reduction, balance sheet driven downturn that's likely to linger for years, not the run-of-the-mill inventory / employment based correction typical of the post WW2 period.

Please and Thank You

As we've noted in previous letters, referrals from clients and friends are the lifeblood of our business; your kind words are our only advertisement. Referrals to Harmonic of your friends, acquaintances, coworkers and family members are the highest compliment and are greatly appreciated. Thanks in no small part to those referrals, our "Assets Under Management" total has continued to expand. We've also been asked to present proposals to several leading Idaho nonprofit organizations, have had encouraging conversations with institutional consultants about our stock strategies and have enjoyed a steady stream of new private clients. As always, we hope you'll feel free to forward our commentaries and this letter to those whom we may be able to assist.

As a reminder, Harmonic focuses on the following private client types:

- Nonprofits
- Profit-sharing plans

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- Investors whose retirement investments are in transition or in need of organization or optimization
- Investors who'd like to participate in Harmonic's industry-leading stock strategies as a part of their existing brokerage account
- Those who understand that investing is not a speculative short-term game, but is a contest that is won by methodical behavior and disciplined thinking

Personal Notes

It was mostly "nose-to-the-grindstone" during the fourth quarter for Kevin and Kenn. We each had a quiet, family-oriented Thanksgiving and year-end holidays and enjoyed the slightly slower pace the markets, and life, seem to take as the year winds to a close.

Our best to all for a healthy, enjoyable and profitable first quarter.

Kevin A. Jones, CFA

Kenn Lamson, CFA