



Arbor Capital Management

Investment Overview

The US economy appears set to report near-flat GDP growth for the first quarter. An extraordinarily harsh winter caused many Americans to simply stay home. There is no denying that cheaper energy prices leave more money at the end of the month. Though pushed back a bit, we expect consumer spending to show a nice uptick this summer.

Meanwhile European growth has picked up on the devaluation of the Euro and quantitative easing by the European Central Bank (ECB). This has made US bond yields more attractive on a relative basis and the Dollar has surged as a result. In an unusual turn of events the US is directly benefiting from the ECB's strategy. This is proof positive that the world economies are more closely linked than ever.

The Fed is likely to leave rates unchanged until clearer trends develop. Bond prices in the US are being buoyed by foreign purchase especially from countries that have negative nominal interest rates. The US is not particularly well off, just in better condition relative to our competitors. Many expect the Fed to raise short term interest rates this autumn. They may be right. Time will tell. It is our feeling that Janet Yellen in particular is willing to err a bit on the side of caution.

Despite the foreign interest in US Fixed Income, we remain cautious. The US currently suffers from extraordinary levels of debt, declining real incomes, a demographic time bomb in Social Security and out of control spending in Congress. So far, we have been able to turn a blind eye on these issues but their magnitude has the potential to create profound downward pressure on long term bond prices. What we are unsure of is the precise trigger that could turn bond investors' sentiment. Consequently, our fixed income portfolios are keeping maturity structures relatively short. This minimizes risk while providing for an opportunity to reinvest at higher yields. We are seeking to add value on an issue by issue basis.

Given the economic cross currents of the past several months it should come as no surprise that stocks were volatile as well. This past quarter the Technology sector was subjected to some negative surprises that impacted our holdings. Corporate purchases are slower than what was expected. As a result sales forecasts were scaled back and that triggered an immediate correction across the sector. We remain committed to tech in the longer term and believe the current demand shortfall is a temporary setback. The conversion to 64 bit computing is still in its early stages and will continue to build in complexity and efficiency

impacting each of us in both our personal and business lives. There are likely to be a number of “killer” apps emerge even though we don’t know what many of them are yet. To make this point a bit more concrete consider that the PC first was introduced with an 8-bit processor. This meant that 256 bytes of information could be addressed per computer operation. Addressable memory has expanded geometrically as the following table illustrates.

Processor		Addressable Memory
8 bit	2^8	256 bytes
16 bit	2^{16}	65,536 bytes
32 bit	2^{32}	4,294,967,296 bytes
64 bit	2^{64}	18,446,744,073,709,600,000 bytes

The sheer progression of numbers is impressive. In a nutshell computing power has been dramatically improved in a fundamental way. This brings the possibility of supercomputer power to the home user. It is not without a downside, however. Because the word length is now 64 bit, even the number one (1) requires 63 zeros in front of it. This means that the demand for onboard memory and storage will exceed what is common today by a large factor. Bottlenecks will crop up that will need innovative remedies. For example, solid state drives are likely to dominate in years ahead. Both technological and production capability will be stretched.

In our view the flow of new applications will follow two disparate paths: Massive data crunching programs and the internet of things. Personal genome mapping in your Physician’s office is one endpoint that seems promising. The internet of things is really a collection of devices to measure, control and/or communicate regarding very specific roles. Many of these are available to consumers today such as Thermostats, Garage door openers, Security systems all in communication with your remote device. Others are industrial such as process controls and sensors along production lines. Technology has a long history of accelerating growth. We think the next few years will be an exciting time for new commercial development.

Energy is another area that has been volatile. Oil prices have plummeted far past most people’s expectations. New supply from North America and possibly Iran in the near future, combined with weakness in global economic growth. It is our feeling that once economic growth reasserts itself oil prices will begin to climb once more. As discussed previously, consumers and refiners are the principal beneficiaries of this decline.

We have been actively reassessing many of our positions to make sure we are in the best possible position for the next year or so. Hence, turnover in the past month or two has been higher than usual for us. We think we have taken many positive steps toward improving potential returns going forward.

As a registered investment advisor, the SEC, under the Investment Advisors Act, requires that our written disclosure brochures be delivered to each client and prospective client. Enclosed is the Summary we are required to supply at least annually. In addition to this

summary, we offer to send you our current Firm Brochure with additional information should you request it. If you would like to receive our current Firm Brochure, please call or write Beth Eustace, Chief Compliance Officer, or the undersigned.

We appreciate the opportunity to be of service to you. Please call us anytime to discuss your account, particularly if you have any changes in your goals or lifestyle. We extend a special welcome to the many new clients who have joined the Arbor family in the last quarter. If you know someone or any organization that you believe would benefit from our services, please mention our name. We would be honored to have more clients like you.

Sincerely,

Gerald T. Cole, CFA
Chief Investment Officer

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