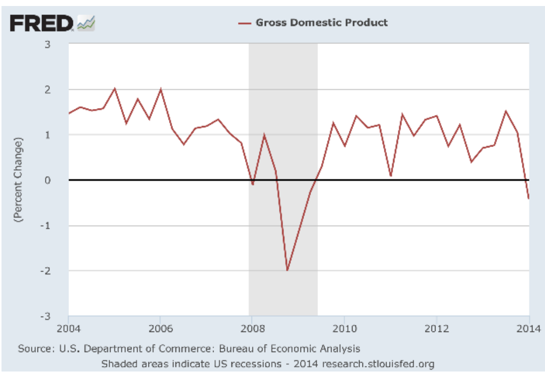
Arbor Capital Management

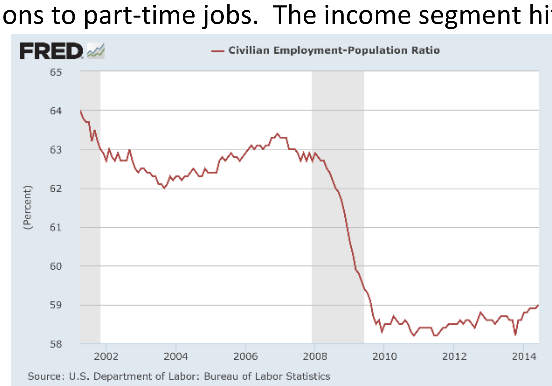
Investment Overview

Economic forecasting has always been a risky undertaking and this year is no exception. Along with many other market watchers we were a little surprised that the economy contracted so sharply in the first quarter. Both the equity and fixed income markets were largely unfazed. Curious.

Economy. The first quarter contraction was blamed almost entirely on the harsh winter weather. At one point, snow was on the ground in every state except Florida. Naturally, this dampened consumer spending. However, we think the continued roll out of the "Affordable" Care Act was a big contributor. Job growth has been severely impacted. News these days focuses on reducing unemployment, which can be easily misinterpreted. There have been some recent periods where the growth in jobs had been exceeded by people leaving the workforce altogether. The combined result is a numerically lower unemployment rate because the labor force is reduced. Currently over 92 million working age Americans are out of work. Increasing the relative cost of full time American employment has three results: 1.) increased incentives to send jobs overseas, 2.) increased substitution of equipment for people and 3.) conversion of traditioanl full-time occupations to part-time jobs. The income segment hit the hardest is the middle class.



Estimates for second quarter US GDP growth are all over the map but the current consensus is for a sharp rebound in growth of +4.2% Provided this is close to the actual number, the total year's growth ought to be around 2.5%. This woud be in line with our general sense of subdued growth. This compares with full year growth estimates of 1.3% for Japan and 1.2% for Euro-Zone countries. India is epected to expand by 5.4% and China is *slowing* to 7.3%. US CPI is expected to remain just over 2% for the next year or so. Until job growth expands, it does not appear likely that inflation will accelerate much. We expect pockets of inflation to be offset, in part, by pockets of weakness. Therefore, things like grocery bills can expand at the same time that wages weaken. The net may be low inflation but the general standard of living is expected to be under continued stress.



Quantitative easing is tapering more rapidly than we thought likely. Monthly purchases have been reduced by more than half. The Fed estimates that they can conclude the purchase operations in October of this year. It was a concern that the reduced demand for new bonds would lead to a general rise in rates. That still may be the case but delayed a quarter or two. Insofar as global interest rates are concerned the US remains among the least bad of a bad set of economies so foreign demand for Treasuries is still comparatively strong. Given the underlying rate of inflation above 2% it is easy to envision a return to ten year Treasury yields of 3% or higher within the next year or so. Our fixed income strategy reflects this concern and our portfolios are generally short and defensive.

We are often questioned about Gold. Given the muted inflation outlook, Gold ought to remain in a tight trading range with a slight upward bias. Political changes and military adventurism (Russia, ISIS) are expected to be the main stressors that could drive Gold prices well outside its fundamental value. These events are not easily forecast.

Even though the economic backdrop was weak during the first quarter, stocks rose. The main reason for this is the high risk premium still assigned to stocks

The current earnings yield of the S&P 500 is over 6% which is relatively attractive when compared to the ten year treasury yield of 2.5% If the future reverts to the historical mean then share prices are moderately undervalued. So far this year this has kept the flow of funds moving into stocks. For the next 12 months or so it would appear that the valuation under pinnings still slightly favor stocks. That is not to say that selling squalls motivated by any number of factors cannot happen. They often do. Provided earnings accelerate as they are forecast to do in 2015 any correction of 5-10% should be followed by new highs. We remain committed to high quality core names in each of our equity strategies.

If you have an interest in increasing income, we suggest that you consider our Global Equity Income strategy if you have not already done so.

Sincerely,

Gerald T. Cole, CFA **July, 2014**
Chief Investment Officer

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