Arbor Capital Management

## 2017 First Quarter Economic Outlook

2017 promises to be a lively year. Beyond a doubt the election of Donald Trump marks a dramatic change in a multitude of policies. In our view, investors should regard most of the economic proposals set forth favorably. It is impossible to evaluate them with precision but they are generally sweeping changes that are large in magnitude with long lasting effects on the economy, financial markets and future opportunities. In this letter, we attempt to begin to examine some of the key points as we see them at this time.

Economic growth after the 2008 recession have been anemic at best. As we identified at the recession's outset, the key to climbing out of this particular pattern was job creation. Labor participation rates have languished and have substantially offset reported reductions in unemployment because once a worker becomes discouraged to the point of no longer looking for work they are no longer counted in the most prominent unemployment statistics. The lack of growth of consumer demand growth was a strong contributor to global economic stagnation. We are optimistic that the new administration in Washington will help provide the impetus to kick start the engines of growth that the global economy so desperately needs.

**Repatriation of overseas earnings.** US corporations have had to face the world's highest top marginal tax rate. This has driven many to leave profits overseas and reinvest in non-US operations. Currently, the cash holdings overseas are estimated to exceed $2.5 Trillion. Rather than taxing at the 35% rate, it has been proposed to reduce that rate to 10%. If enacted this would likely result in a massive flow of capital back to America. The government would have a significant cash windfall and our economy would experience a huge rush of fresh capital. We anticipate that a large proportion of this would flow into: share repurchases, acquisitions and new ventures. In that order of preference.

The risk here is that some industries becomes too concentrated and anti-competitive. Some additional incentives may be needed to assure repatriated funds flow into growth supporting projects.

**Manufacturing Jobs.** Trump is nothing if not a salesman. Even before inauguration, he has pursued commitments of major employers to expand operations in the US as opposed to elsewhere. However, it would be a mistake to assume that the jobs being created here would be the same as the jobs that left or in the numbers promised. Technology has changed a lot. Manufacturing these days is highly automated. The number of workers employed to produce the same output is significantly reduced. Increased productivity is an absolute requirement because the shifting of jobs back to the USA has a profound effect on the countries from which they are returning. For example, with the declining peso the wage advantages of Mexican workers would only expand. Competition for these jobs is keen. In order to keep them in this country US workers need to figure out way to produce cheaper, better and faster. Persuasion in this regard has a limited shelf life. The US worker needs more than ever to be exceptionally well trained in order to be able to survive in the long term. The US will also need to transform itself into a knowledge based economy. Given the current state of many of our cities' schools this is a tall challenge. However, it must be met if we are serious about securing the future of all Americans.

**Trade Agreements**. Trump's statements regarding trade relations have caused alarm in some circles fearing the start of growth killing trade wars. The reality is we have been in de facto trade wars for decades. Cheating against the US has almost never been met with a meaningful consequence. Trade agreements such as NAFTA had been negotiated with a lenient attitude, hence, Mexico is allowed a 15% tariff on US imports with no reciprocal arrangement. China's trade offenses have been largely ignored. Movement toward fairer trade would be most welcome.

**Monetary Policy / Fixed Income.** Quantitative easing is gradually fading into the past. This past December the Fed increased the rate on Fed Funds 0.25% and announced that three additional increases are likely in 2017. Immediately, bond prices adjusted to reflect several potential rate hikes. As business activity increases upward pressure on rates will continue to mount. For the near term this is likely to create a headwind to fixed income returns. Our strategy of short maturities will go a long way to mitigate potential losses and further position our fixed income portfolios to take advantage of rising rates.

**Stocks.** Since the election, stocks have had a very strong rise and seem a little extended in the short term and may be subject to a correction on the order of 5-10%. If our sense regarding the implementation of Trump's economic proposals is accurate, then long term economic growth prospect would greatly improve. Corporate *revenues* will expand about equal to GDP growth while Corporate *profits* will expand at an even greater pace because of the added benefit of reduced taxation and regulatory expense. Large non-recurring corporate profit gains are expected should legislation pass that reduces the cost of repatriating profits.  Provided inflation remains in check share prices should continue to rise.  Long term we have a very positive outlook for equities.  As events unfold we intend to position client portfolios to benefit accordingly.

In addition to your year-end statements, we are enclosing a copy of our Privacy Disclosure Document in compliance with SEC requirements.

**We are also including the yearly Realized Gain & Loss Report for all taxable accounts.**

Once again, we would like to thank you for your business.  We hope the coming year benefits your personally and financially.  We would also like to extend a special welcome to our new clients who joined the Arbor family in the past quarter.

If you know someone or an 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** **January, 2017**

Chief Investment Officer



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