Arbor Capital Management

Second Quarter 2017 Investment Overview

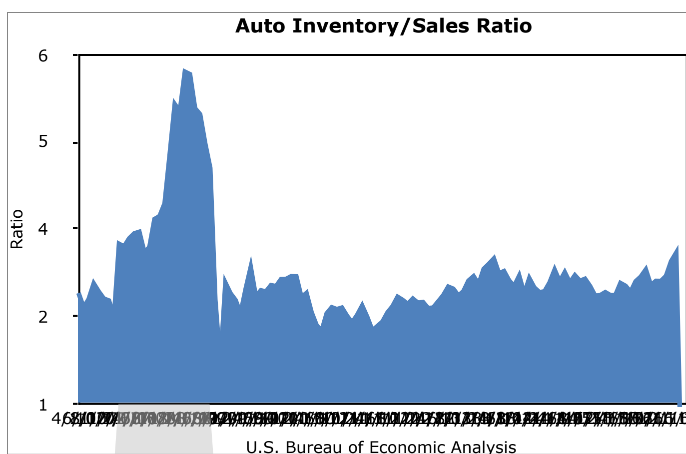
For most of 2016 the United States was in what some would term a “growth recession” that was driven by bear markets in industrial commodities worldwide. The boost to consumer spending that was expected from reduced energy prices never really materialized because they were overwhelmed by the negative effects on oil producers. The worst is over for commodity prices it would seem. Looking forward corporate profits should rebound nicely. Tax and regulation reforms would only strengthen future growth.

Energy. During a surge in energy prices production expands as rapidly as the exploration and production business can muster. This past run up was no exception. Once global industrial production paused, demand for petroleum products plummeted. Production capacity does not enjoy the same responsiveness. Oilfield development is a lengthy capital intensive business. Currently, there is a lot of excess production capacity. Of course, OPEC production cuts help set a price floor but we don’t think they can trigger a rapid price increase any time soon. Practically every oil producer is strapped for cash. For example, the Saudis, Russians and Venezuelan governments all need the cash to fund social spending. Shale producers on the other end of the spectrum need to produce in order to meet debt service requirements. All this suggests that the supply of crude will remain plentiful for the foreseeable future. A rapid return to $70/bbl. does not appear to be in the cards. Low growth in oil prices will likely lead to underinvestment in productive capacity over a period of years that would set the stage for the next oil price “boom.” A signal suggesting an upward change in Oil’s price would be shown in persistent declines in inventories. This moderation in energy cost has several distinct benefits: A boost to consumers’ discretionary income and reduced production costs across many manufactured goods. These benefits combine to help mitigate against inflationary pressures and potential interest rate increases.

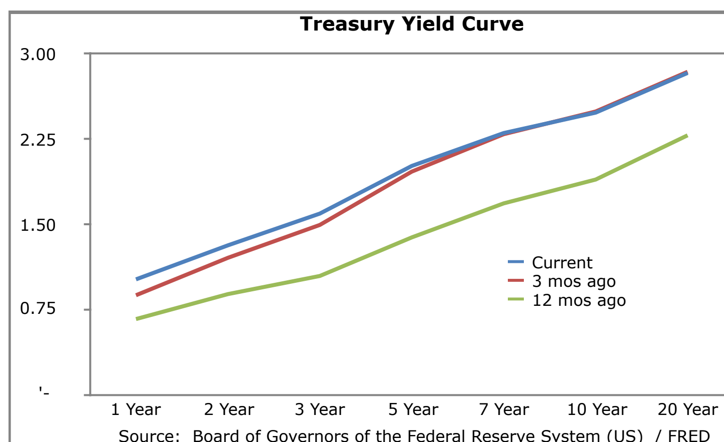
Bringing up the slack. For most of 2016 corporate earnings struggled to improve. One of the few bright spots in the current economic recovery was the rapid expansion of the capital goods sector. As these sales softened so did demand for industrial commodities. Oil and metals were particularly hit hard. Over the past few months this has taken a turn for the better. Not surprisingly some commodity prices have firmed a bit. Total capacity utilization is trending higher. These are very positive signs but are increases from very depressed bases. This means expansion can continue for quite a while before inflationary pressures arise from general capacity constraints. While seemingly obvious, the real benefit suggested here is a real expansion in wealth and incomes across broad swathes of the economy should the Trump

program prove to be, even moderately, successful. We believe it is this realization that has driven consumer sentiment to a twelve-year high. Job creation has demonstrably improved to the point that unemployment rates are approaching levels usually associated with full employment. Full employment historically gives rise to wage inflation. Since the labor force participation rate has declined over the past 8 years we suspect that upward pressure on wages may be partially muted by some people re-entering the workforce. Job formation and real disposable income could grow while the unemployment rate remains flat/low because the labor force would be expanding.

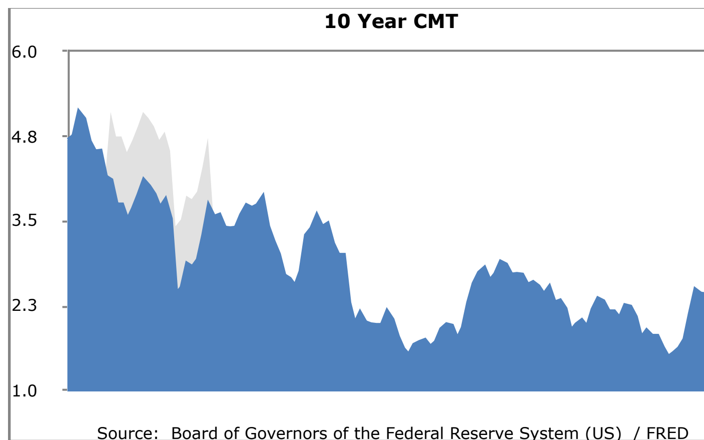
Consumer. Major consumer purchases such as Homes and Autos have been fairly strong. Housing prices have yet to return to their pre-2008 levels so there is probably more upside to home prices. In contrast, automobile sales appear to have gotten temporarily ahead of themselves. Automobile Inventory relative to Sales is a little high. This suggests that inventories will need to be cleared in advance of the new vehicle model year. In addition, non-performing auto loans are building. Typically, these are danger signs but the strengthening consumer situation suggests that this may only cause a reduction in growth rather than something more serious. This situation bears further watching. At this point, we suspect that this will work itself out. Since leasing has been so popular there may be an over-supply of used vehicles building. Consumers may find this summer to be a buyers' market for vehicles.



Interest Rates. Interest rates are up a bit along the entire yield curve. Forward looking inflation expectations have picked up a little. Some have felt that there might be as many as four Fed rate increases this year. Part of the rationale behind this belief was that Trump would be able to implement his proposed policies at a much faster pace than appears to be happening. Even if each program were to be implemented in due course, the simulative impact is being shifted into the future. Expectations for large increases in economic activity and inflation pressures appear to be ahead ofthemselves. In just the past few weeks bonds have rallied reflecting a more subdued economic forecast. The pace of rate increases looks like it may be pushed back as well



Fixed Income. Our bond strategies are deliberately neutral for the time being. Regardless of one's feelings toward the people advocating the positions, growth oriented fiscal policy is very



likely to pass Congress. With it will come increased economic activity, inflation pressure and loan volume growth. These factors all point to rising interest rates commensurate with the rate of growth of nominal GDP. At year-end, the 10 Year Constant Maturity Treasury (CMT) is expected to yield a little over 3%.

Stocks. The equity market rally after the Trump win went longer and further than we expected or feel are warranted at this time. We think a pause would be healthy within the context of a longer-term bull market. This could take the form of a general price correction or a sideways move over an extended period of time. Either way market imbalances will need to be resolved to reinforce the longer-term uptrend. Health care reform discussions are likely to impact prescription drug prices. Growth portfolios are currently over weighted in Pharmaceuticals and we will reduce exposure toward market weight. Despite the prospect of near term volatility, we think the trade policies, reduction in regulation, buy America / hire America all work to benefit both corporate profits and household incomes.

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 **April, 2017**

Chief Investment Officer

This report has been prepared by ARBOR CAPITAL MANAGEMENT for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, except with respect to information concerning ACM, its subsidiaries and affiliates, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. The report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or group of ACM as a result using different assumptions and

criteria. ACM is under no obligation to update or keep current the information contained herein. ACM, its directors, officers and employees, or clients may have or have had interest or long or short positions in any securities or other financial instruments referred to herein, and may at any time make purchases and/or sales in them from time to time. Neither ACM nor any of its affiliates, nor any of ACM' or any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. ***Additional information will be made available upon request.*** *Past performance is not necessarily indicative of future results.*

For investment advice, clients or interested persons should contact their Arbor Capital representative.

Lawrence T. McGowan

100 Corporate Pkwy, Suite 308

Amherst, NY 14226

(716) 446-9111

ltmcgowan@arborcapitalmgt.com

Matthew J. Wilkinson

100 Corporate Pkwy, Suite 308

Amherst, NY 14226

(716) 446-9111

mjwilkinson@arborcapitalmgt.com

Leo Mesa, CFP

790 Juno Ocean Walk, Suite 600

Juno Beach, FL 33408

(786) 202-0602

lmesa@arborcapitalmgt.com