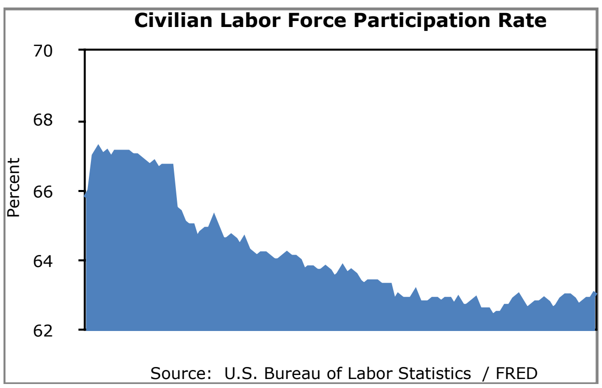
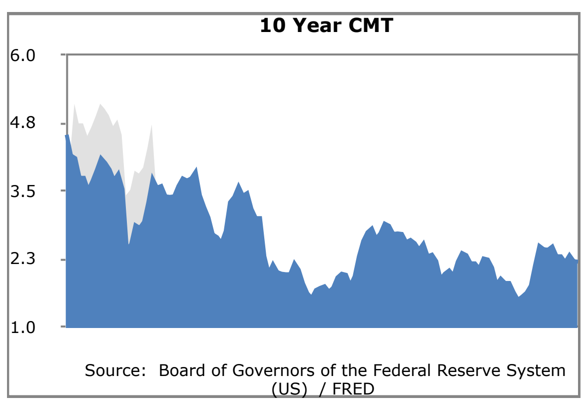
Arbor Capital Management

# Fourth Quarter 2017 Investment Overview

The economy continues to progress at a slow but improving pace.  Despite the long period of the current economic recovery, some improvements are surfacing that suggest the expansion may still have room to go.  The theme for the next few quarters would seem to be “turning corners.”

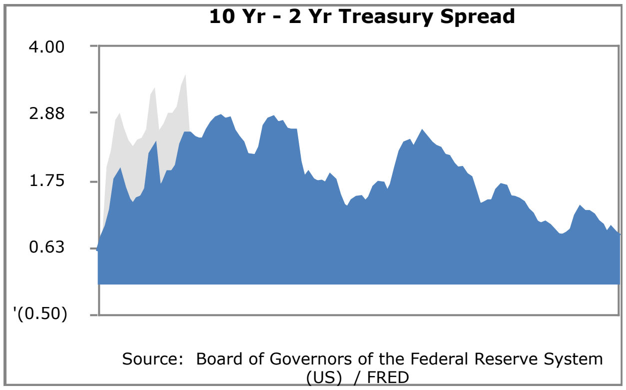
**Employment.**  The main barometer of economic growth in this country is jobs.  Regardless of how one measures them, Unemployment yardsticks have been improving for a few years but had been masking a worrisome downtrend in Labor force participation.  Recently, the participation rates have shown some signs of recovery which suggests workers are (re)entering the Labor Force at an improved rate.  Hopefully, this marks a turning point for American workers.  Many of the jobs lost will remain so but we are hopeful that a large number will return and a few new categories may emerge. While we can’t prove it, we think that some of the expense associated with moving manufacturing overseas has not been fully accounted for.  Quality control, shipping, theft, and the entire logistical chain all present significant challenges that take years to fully appreciate.  Some readjustment seems natural.  Other impediments to job creation have been:  the Affordable Care Act, excessive regulation and high corporate tax rates.  As each of these are reduced, we expect an improvement in the relative value of American labor.  Demand ought to follow.




**Interest Rates.**  For years we have witness a secular downtrend in interest rates most recently capped by the Fed’s use of quantitative easing that pushed rates to historic lows.  The Fed currently has a bloated balance sheet through accumulation of bonds during the financial crisis.  They intend to simply let the portfolio mature without fully reinvesting the proceeds.  The removal of its artificial demand will help put an upward bias on interest rates until the program is completely unwound in a few years. When added to the building overall economic strength we may have seen the bottom in interest rates for a generation. Only time can tell. What we do know, however, is that long term interest rates are typically 3-4% plus the inflation rate. Current inflation is running right around 2%. Arithmetically, long term interest rates ought to be trending toward 5%. Negative interest rates in some key parts of the world are holding that possibility at bay. At the least we expect that rates will drift higher throughout the remainder of the year and into next.

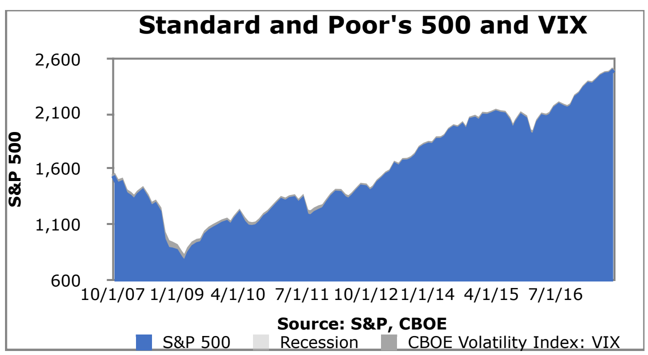
**Fixed Income**. Higher interest rates are a double-edged sword. We expect the upward pressure on rates to apply downward pressure on fixed income holdings. Our bond strategy is well suited for this. As bonds mature in the near term we will be able to recommit at higher yields. This will improve cash flows on one hand but will apply downward pressure on long term maturities. The chart to the left shows that the incremental pick up in yield by selling 2 year paper in favor of 10 year paper is very small. It simply doesn't pay at this time in our opinion. Similarly taking on credit risk by purchasing lower rated bonds has a minimal benefit. If you are holding long term bonds elsewhere, now would be a good time to consult us on how to better protect your principal.



Source: Board of Governors of the Federal Reserve System (US) / FRED

Rising rates present a number of challenges to securities markets, however, there are some positives. Retiree incomes could benefit. Provided principal is preserved cash flows can successfully be managed upward.

**Stocks.** Equities in general are fully valued by historic standards and fairly valued relative to risk-free interest rates. Fortunately, they can remain so for a long time. In order for share prices to advance then earnings growth needs to support valuations. Despite a number of uncertainties, investors, evidenced by the VIX remain calm. This suggests that much of today's news even if negative has been digested and accepted. It is the unexpected event that usually triggers corrections. There are three potential shocks that could cause investor upset: 1.) An interest rate shock is always possible but seems unlikely at this time. Artificially low interest rates will not last forever. Should interest rates rise as we expect, P/E multiples would gradually come under pressure making valuations all the more critical. Sharp movements in rates would likely trigger corrections in the overall equity market. The Fed is doing its part to promote stability by signaling its intentions well in advance in order to provide investors with plenty of time to adjust to rate increases. Investors have an easier time digesting negative news if it is logical and widely understood. 2.) Foreign crisis from North Korea or Iran is possible but totally



Source: S&P, CBOE

unpredictable, 3.) Tax reform may fail in Congress. Much of the current market optimism is based on pro-growth corporate tax reform and fiscal stimulus. Earlier in the year we viewed this as a near certainty to pass. However, Congress is in gridlock making an impasse in tax policy the markets' greatest potential threat in the near term.

We are sticking with our discipline of strong value and fundamentals in our equity selection process. Sometimes this results in seemingly contrarian names being added. This is the case with recent purchases of Ford and IBM. Ford has undergone a management change that promises to re-energize the company's operation. IBM has had difficult sales comparisons as it is attempting to reinvent itself as a big data / artificial intelligence provider. We also think that there are emerging positive trends in Coal and Natural Gas. Clean Coal technologies are being aggressively developed and Coal is being exported again. Export restrictions on Natural Gas have been relaxed. Ready markets are available in Eastern Europe where the only source for Gas had been Russia.

In addition to your quarterly statement, we are enclosing a copy of the amendment change adopted by the SEC in July, 2010. "Amendments to Form ADV Part 2A: Firm Brochure.

Clients with taxable accounts will find your Realized Gain and Loss Statement through the first three quarters of 2017 enclosed. You may wish to share this information with your accountant and advise us of any tax planning as soon as possible. Also, we would like to remind our IRA clients if you need a distribution from your IRA, please notify us prior to December 1, 2017 in order that processing is accomplished in a timely manner.

The continued response to our website has been overwhelming. If you have not had an opportunity to visit www.arborcapitalmgt.com, we invite you to tour the site. We hope you are enjoying "Financial Insights" our email video series on a variety of financial topics. We welcome your comments and suggestions for new topics to discuss.

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. Also, you should be receiving custodial statements directly from your qualified custodian at least quarterly. If you are not receiving these statements, please contact us so that we may assist you in resolving this matter.

We extend a special welcome to the many new clients to 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** **October 24, 2017**

Chief Investment Officer

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


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