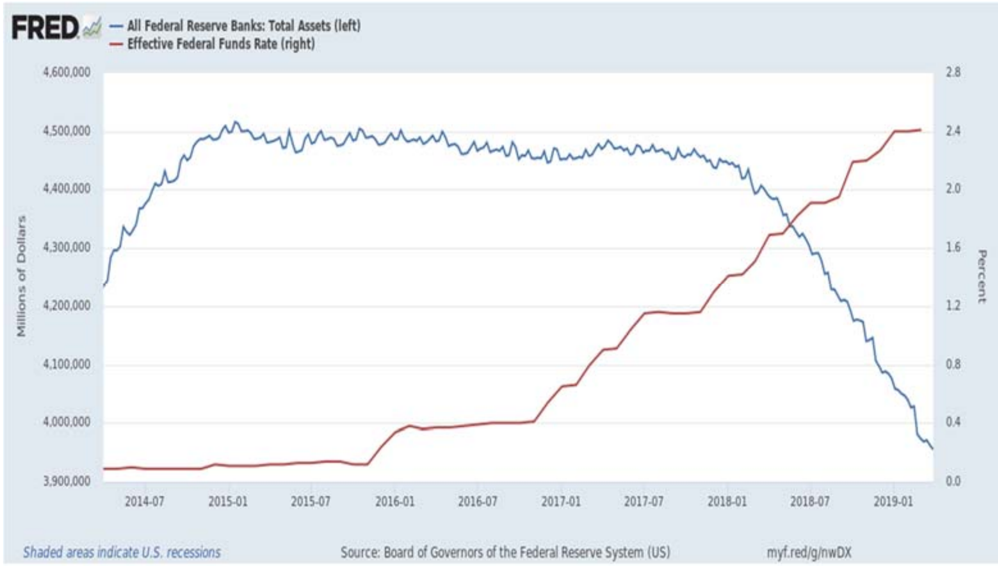
Arbor Capital Management

Second Quarter 2019 Investment Overview

What a difference a quarter makes. Stocks have posted a strong recovery beyond most people's expectations. 4th quarter 2018 and 1st quarter of 2019 GDP is below trend. We think the US economy will resume its 3 + % growth rate for the balance of the year. We view the economic glass as half-full.

This business cycle has not recovered from the last recession by any of the usual metrics. Instead, it has been a long, tough go for most folks. Still, unemployment rates are at or near record lows. Discouraged workers are re-entering the workforce and productivity is about in line with wage growth. Consumer spending and capital spending are solid. Home prices have recovered to their pre-crash levels in most municipalities. The Purchasing Manager's Index just reported at 55.3% indicating a robust manufacturing sector, which supports our growth forecast. Repatriation of overseas dollar holdings is proceeding ahead of expectations. Goods-producing companies are (re)opening new (shuttered) plants that will bolster long-term domestic growth. Trade deals with other nations are leveling the playing field to fairer structures with greater reciprocity. A tariff-free environment is ideal but beyond reach for the foreseeable future. However, realignment of trade deals also creates some near-term disruption in economic activity, even if the long term result is favorable.

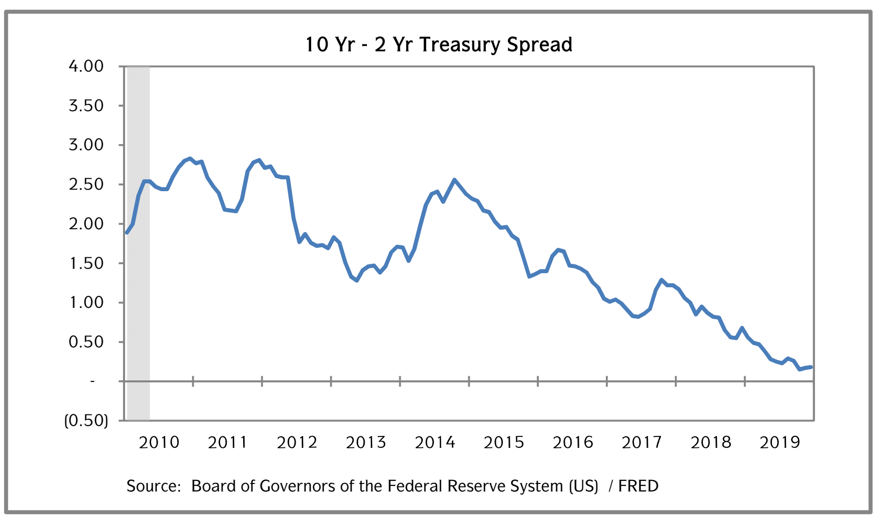
Despite all these constructive elements, recession risks are rising. The principal culprits are economic weakness abroad and Fed policy. It is no secret that China and Europe have been struggling to grow over the past few years. Recently Italy has fallen into its 5th recession in 20 years, Australia is technically in its first recession in 27 years, and Germany's manufacturing sector is stuttering. Meanwhile, the Fed is trying to raise interest rates to buy some breathing room for future policy discussions while shrinking its balance sheet that had been inflated through quantitative easing at the same time. At the moment, the Fed policy actions are more dominant. The chart below illustrates the Fed tightening actions over the past three years. The blue line is the aggregate size of the Fed's balance sheet. About two-thirds of it is solely due to quantitative easing programs. For the most part, it was flat (stable). Commencing in January of 2018 it was more aggressively shrunk. Qualtitative easing effectively printed money. Quantitative tightening does the opposite; it erases money. This is a powerful mechanism that is untested and warrants caution. At the same time, the Fed was also raising short-term rates. In a related action, the FHA has



tightened standards for its mortgages. In sum, several banking components were restricted concurrently that we feel are playing a central role in slowing economic growth. In its recent minutes, the Fed said it had put its tightening programs on pause for the time being. The next potential rate hike does not appear likely before the fourth quarter of this year. The reduction of the Fed's balance sheet is deflationary. Therefore, we think the Fed's portfolio liquidation will likely slow considerably going forward to avoid putting on the brakes too hard. This may require purchases from time to time to partially offset the volume of maturing securities. In this set of circumstances, a little inflation is helpful.

We think it is fair to say that the margins for economic policy error are becoming narrower. We expect to experience a recession at some point but not for a while.

Fixed Income Strategy. The current shape of the yield curve presents practical limits to our new purchases. There is very little value in fixed coupon bonds maturing much more than two years away. In fact, there is almost no yield advantage to purchasing fixed coupon bonds past two years at this time. We may, however, buy floating rate or step-up bonds with longer stated maturities if the appropriate relative values present themselves.



Equity Strategy. We are in the later stages of a bull market. Accordingly, we are focusing on purchases that tend to be more value oriented and offer higher dividend yields. In a unique twist to his particular cycle, some otherwise defensive companies have chosen to leverage themselves to the point that their earnings have become much more sensitive to the overall economy than has been the case historically. Selection, even among defensive names is paramount. We are also making purchases in anticipation of the 5G wireless rollout expected over the next year or two.

As a registered investment advisor, the SEC, under the Investment Advisors Act, requires that our disclosure brochures be delivered to each client and prospective client. 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 Sandy Dodson, the undersigned or go to SEC.GOV.

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 17, 2019**

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