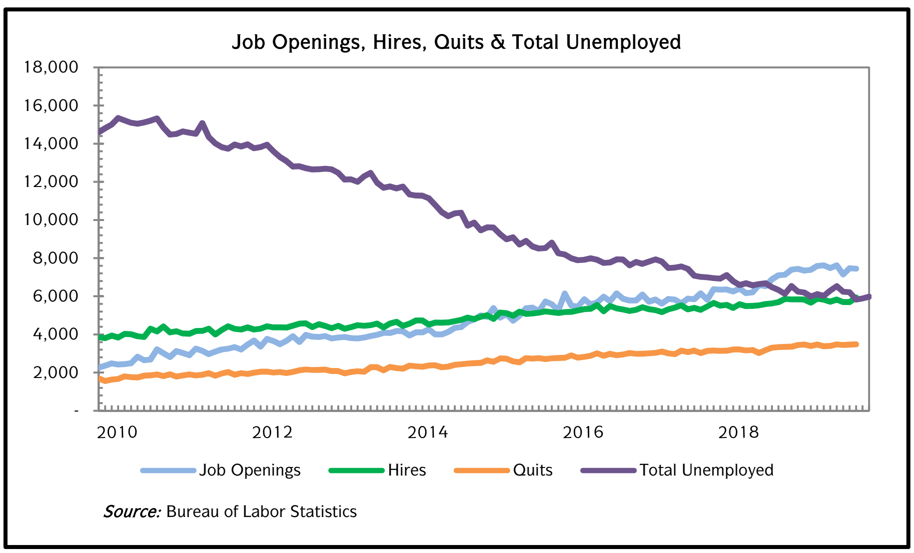
Arbor Capital Management

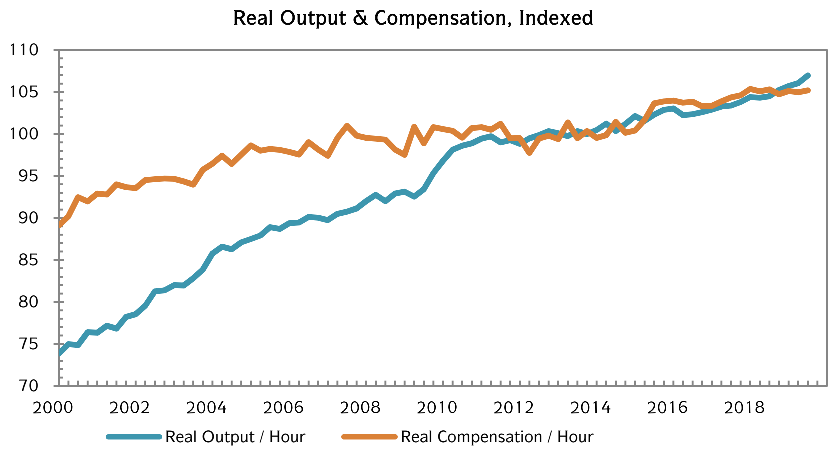
Third Quarter 2019 Investment Overview

We are living in very interesting times. The US economy and financial markets continue to exceed expectations which are made all the more remarkable given the anemic backdrop around the rest of the Globe. Many investors are nervously wondering when this could come to an end. Our answer? Not for a while. It seems as soon as economic weakness appears, it reverses course the following quarter.

The US Economy continues to grow despite an already record-setting expansion. Unemployment across every demographic are either at or near all-time lows. There still are more jobs available (7.3 million) than unemployed workers (5.7 million). This disparity means new employees will need to enter the labor force either from immigrants or from a part of the population that is outside the labor force. One could probably argue that the tightness of the labor market is hampering the overall rate of economic growth. Full



employment, such as we have today, is often associated with building inflation. The reason why jobs growth can be so robust with rising real (inflation-adjusted) wages is that output per hour is in step with compensation per hour. As long as these conditions are present, real wages can expand, jobs can be created, and inflation can be maintained near zero.



Source: Bureau of Labor Statistics

For the time being, at least, we are living in a Goldilocks scenario: Not too hot, not too cold, just right.

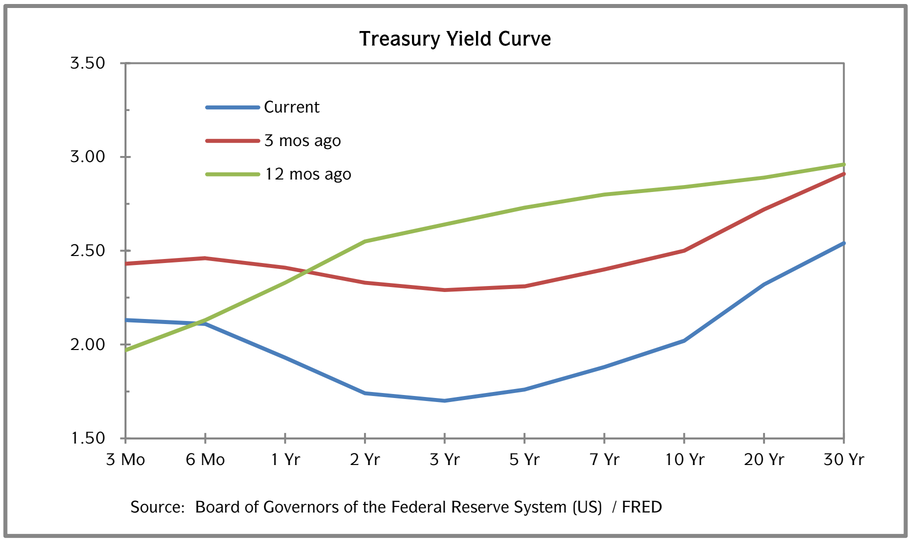
Trade. The USMCA agreement has been ratified by an overwhelming margin in Mexico (114-2) and is awaiting approval by Congress. Canada will likely vote on its approval after this year's general election that is scheduled to occur on or before October 21.

Negotiations with China continue to wind along. Since China will have to make some meaningful concessions, it should come as no surprise with some push back. Until a deal is signed, we expect that there will be several twists and turns that could drive share prices in one direction or the other. We believe that China and the US will eventually agree to terms that will be far more fair toward the US interests than was previously the case.

The Purchasing Manager's Index was recently reported at 51.7, which is signaling expansion in manufacturing. While exceeding forecasts, this is down from a recent high of 60.0 one year earlier. Over time this metric can be volatile, requiring some contextualization of the information. The realignment of US trade policy and tariffs are causing some supply disruptions. Ratification of the USMCA and resolution of the China trade conflict will ameliorate much of this. On a more positive note, end-customer's inventories are suggested to be too low. At some point, inventory replenishment will boost growth.

In our opinion, the most significant risk to continuing economic growth is not in any of the time-series that we follow. Instead, self-fulfilling attitudes towards business decisions can lead to recession. As a practical matter, a large part of the Fed's role is fostering a constructive business climate.

Interest Rates. In retrospect the Fed moved too rapidly in raising rates while allowing their bond inventory to run off last year. The combination of the two overdid things a bit, and we would expect a rate reduction relatively soon. The consensus seems to anticipate three successive rate cuts of 25 bps each. The US economy was probably strong enough on its own to support the tightening moves. However, economic weakness abroad had an impact.



Interest rates in Germany and Japan are negative, making US Treasuries all the more attractive driving yields downward. We think this has amplified demand in the 2-5 year maturity range. Currently, the Treasury yield curve is inverted in the short end from 3 months to 3 years and positively sloped after that.

Fixed Income. Historically, the fixed income manager's response to this curve would be to create a "bar-bell" portfolio, concentrating holdings at the short end and long end of the yield curve while avoiding the middle section. However, in today's circumstances, the yields available at the longer end of the curve are insufficient to motivate us to make large-scale commitments. 10-Year Treasuries are hovering around 2% while the 30-Year is around 2.5%. Our response at this time is to stay predominately short in term to maturity. We also have been able to find value in step-ups which raise the coupon rate based on a formula calculation at a future date. We continue to emphasize high credit quality.

Equities. Corporate profits are facing headwinds of tough prior year comparisons, international trade tensions, and Fed tightening, causing growth rates to slow. On balance, we think the backdrop for stocks remains constructive. The sharp appreciation year to date suggests to us that a 5-10% correction could take place in the relatively short term, most likely driven by an external event such as an announcement about the failure or success of trade negotiations. Since we are confident that some favorable resolution is likely, we would tend to use negative developments, should they occur, as buying opportunities. Our selection emphasis is a little eclectic. We are in an extended economic cycle so we favor higher dividends and stable earnings. On the other hand, much of today's economic policy is very positive in the long term for continued job creation and industrial expansion so we also hold companies that will benefit such as Steel and Infra-Structure related names.

Going forward, if you would like to receive this letter and quarterly report electronically, please send an e-mail to us at smdodson@arborcapitalmgt.com and ask to be added to our electronic distribution list.

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 **July 24, 2019**

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