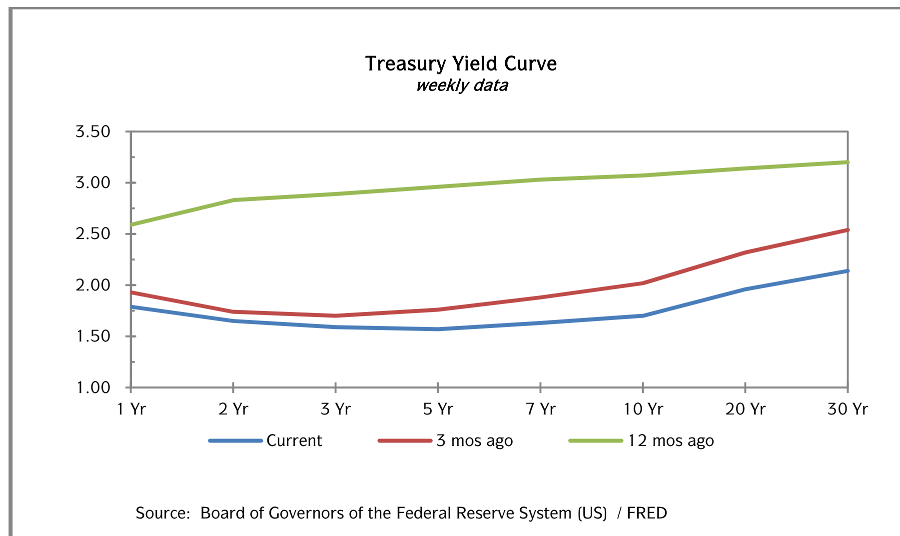
Arbor Capital Management

A Pure Asset Manager

Fourth Quarter 2019 Investment Overview

The US economy continues to extend its record-setting business cycle. The economy is expected to grow by 2.5% for the full year 2019. Both the Fed and the IMF are forecasting continued expansion through 2020. This quarter we highlight some of the central factors at play and how we intend to weather the transitions we anticipate over the next few quarters.

Interest Rates. The Fed is still a little out of step with Main Street. The Fed allowed a significant portion of its bond positions to roll off its portfolio at the same time it was raising rates in 2018. The combined effect sapped liquidity and raised the short-term cost of funds. Financial markets have been struggling to recover ever since.



Currently, the Fed Funds rate is about equal to the rate of inflation, which suggests it is fairly priced. However, yields on five-year U.S. Treasuries are lower. We think this is explained by negative yields overseas and the expectation that inflation will remain very low domestically for the foreseeable future. A side-effect of this is the continued strength of the dollar. In the bigger picture it makes sense to us for the Treasury to extend the term structure of its debt as long as practically possible to take advantage of negative real interest rates. From a domestic policy standpoint, conditions are ideal to fund a massive

public infrastructure project. Rebuilding roads, bridges, airports, ports, and the electric grid would improve the quality of life and support continued economic growth. That foreign investors are willing to finance it at a discounted rate, is the icing on the cake. There have been discussions about the Treasury issuing 50-year and 100-year bonds.

China. Trade negotiations with China appeared to be going along swimmingly until the Communist hardliners reasserted themselves. Subsequently, the People's Republic of China's central committee reversed many of the previously agreed upon terms, took a more aggressive stance toward Washington and, significantly devalued its currency. Responding to these actions, the President then followed through on raising tariffs on an additional $300 billion in imports. Our take is that the new tariffs will negatively affect both economies. China will suffer far more, however. Both countries are far better off with fair and reciprocal trade. The lop-sided terms that American companies have had to suffer through are no longer tenable for the United States. China likes things just the way they were. It is impossible to determine what will break the impasse. We remain optimistic that the US will eventually emerge from these trade disputes in an improved long term position. However, both the terms and timing of an eventual trade deal remain uncertain. Consequently, many company managements may simply defer large commitments to new projects until a clearer picture emerges. In a broader sense, there is likely to be a slowdown in earnings growth for some companies. The combination of all these factors will contribute to earnings volatility that could lead to wider swings in share prices, in our opinion. A slowdown in manufacturing production raises the potential of recession but, we think this is still a low probability within the next year.

We think fears regarding accelerating inflation and supply disruptions are overdone. Some of our clients have given us examples where they were able to pass the entire increase in cost from tariffs through to their customers. Other clients have not had any material impact from tariffs. The ultimate effects will take time to play out for four reasons:

1.) At any point there is at least a month's supply of inventory in transit which provides a short-term buffer.
2.) Alternative suppliers of goods can be rapidly found for many goods categories.
3.) Competitive pressures will cause margins on many product segments to contract, at least temporarily.
4.) China is no longer the cheapest supplier of labor. Jobs requiring unskilled labor will migrate to more trade-friendly countries.

Opportunities in China may still surface over time, but the abrupt assertion of communist ideals in trade and governance of Hong Kong serves as a reminder that future trade partners should beware.

Jobs. The labor market in the U.S. is as strong as it has been in 50 years. Unemployment statistics by any measure are at or near historic lows. Long-term unemployed or so-called discouraged workers are reentering the labor force. Consumer credit appears to be in good

condition. Debt as a % of GDP is low, Consumer Debt Service Payments as a % of disposable income is very manageable by past standards. Credit Card Delinquency is near record lows. Home equity loans are well off their 2009 highs but should continue to make

progress. Mortgage rates have room to decline in the current monetary climate. Should the Fed ease enough, mortgage rates could potentially decline to the upper to mid 2's, which would trigger a refi boom in economic activity in our view.

Fixed Income. Investors are not being rewarded for risk-taking in bonds. Credit spreads are narrow and there is no yield advantage to extending maturity. What we are doing in this situation is picking and choosing the best possible bond values that fit specific portfolio objectives, case by case. In a general sense, we are emphasizing high quality and short maturity.

Equities. Stocks are a more mixed bag at this juncture. Some names that are economically sensitive appear to be discounting economic outcomes that are far worse than what we feel is realistic. Still, the economic cycle is long in the tooth so defensive names tend to be favored. At this time we feel that reports of the death of the current business cycle are greatly exaggerated. Looking forward, we have increased our commitments to deployment of 5G networks. 5G promises to reinvent broadband communication by dramatically accelerating connection speeds beyond that of many hard-wired connections.

Clients with taxable accounts will find your Realized Gain and Loss Statement through the first three quarters of 2019 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, 2019 in order that processing is accomplished in a timely manner.

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 18, 2019**

Chief Investment Officer

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