Arbor Capital Management

A Pure Asset Manager

Second Quarter 2020 Investment Overview

Just a few short weeks ago we thought the prospects of a near-term recession were remote. Now, after the onset of COVID-19, recession or recession-like economic conditions are a near certainty. The extent of mandated closures worldwide is unprecedented. Whether or not the world meets the technical definition of recession, oddly, seems irrelevant. Commercial interruptions have been massive and widespread. However, the longer "self-quarantine" orders remain in place, the greater the impact on us all. We agree with forecasts that recovery, once it commences, will be swift. However, a lot of damage has already been done that will be very difficult to overcome and may effect some noteworthy names.

This quarter we share our perspectives on some of the key issues and why we think there is a strong rationale for optimism going forward. This is primarily a healthcare crisis that has financial impact which is distinctly different than the 2008-09 experience. Financial fallout is inescapable but difficult to either specify or quantify with any degree of precision.

Macro-Economic Backdrop.

1. Most of the world's economy has been dramatically halted. Logic dictates that the effects will be wide ranging and occasionally be surprising. Much of the health of commercial operation is based upon the cash flows that fund operations, debt and payrolls. When transactions come to a stop, revenues are impacted immediately. Most of the expense side continues unabated. The depth, breadth and suddenness of the current slowdown will test nearly every company. In this context, creditworthiness becomes paramount. We expect many companies will experience some type of credit downgrade. We are conducting analysis of our holdings to try to mitigate our clients' exposure.

2. Congress has enacted a $2 Trillion stimulus that is purportedly designed to provide relatively instant relief to consumers and provide a mechanism for companies to help fund company operations. If the current health crisis persists long enough, more stimulus may be required. Checks may not be received by taxpayers until the first half of May. Another $2 Trillion Infra-Structure Program is also being floated as a next step. Items on the agenda include bridges, tunnels, airports, harbors and highways. In the short-term, a capital improvement program of this magnitude would bolster jobs and prices of industrial commodities. Longer term, this should pay dividends of improved economic capacity in support of all forms of industry.

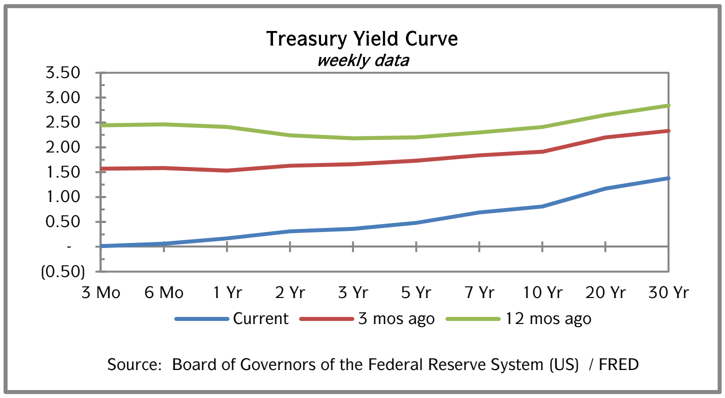
3. Concurrent with the fiscal stimulus, the Federal Reserve pledged another $4 Trillion in fixed income purchases which should bolster liquidity in the bond market. As we learned in 2008, keeping capital markets smoothly functioning is essential to economic recovery. The fiscal and monetary stimuli are projected to reach an unprecedented $6 Trillion. The combined effects should mitigate a substantial part of general economic weakness and hasten recovery later in the year.

4. Crude oil prices have been crushed. From December through the first half of February, oil economics were improving. Then, Russia and Saudi Arabia deliberately boosted oil production which has resulted in a glut of crude supply. Incremental demand has slowed to a trickle. Inventories, meanwhile, have ballooned. We think oil price and inventory stabilization is likely to be a very good indicator that the industrial demand is building and the economy is on more solid footing.

5. Unemployment claims jumped last week and more of the same is expected to continue. Layoffs are expected to grow as the effects of business interruptions take hold. If one were to consider that there are approximately 15mm workers in the hospitality industries the magnitude of the numbers become evident. That is nearly 10% of the labor force. Several economists have forecast unemployment reaching past 20%. Even if only for a brief period, this is alarming. As we have stated many times in the past, high Consumer Confidence correlates with low unemployment. With such a sharp rise expected, we think Consumer Confidence will take a sharp downturn at some point.

6. Supply chains have been disrupted. Ironically the epicenter of the pandemic is also the world's manufacturing center. Starting with the tariff dispute, companies started taking steps to diversify their production out of China to either the US or some other country. The COVID-19 event is accelerating this process. In our view this is a significant shift that will provide a lasting stimulus to US jobs and industries. Additionally, other countries that are more amenable to business than China will be beneficiaries of increased commercial activity.

Fixed Income. As the yield curve illustrates, there has been a flight to bonds in an effort to seek safe haven. For brief periods of time, short term rates have even dipped below zero.



The yield curve is a little misleading, however. Bond market volatility has picked up dramatically as well. Liquidity has been an issue from time to time, but not nearly in the scale of 2008, in our estimation. Given the credit uncertainties in today's climate, it should come as no surprise that credit sensitive bond yields have widened significantly vs. Treasuries. Spreads between bids and offers are much wider than usual which makes trading quite a bit more difficult. Still, we have been able make some opportunistic trades. Market conditions like we are currently experiencing are why we stick to high quality bonds and will continue to do so.

Stocks. After a violent sell-off, stocks staged a relief rally that to many, appeared convincing. We think it is a mistake to assume that the bear market is over. Here's why:

1. Bear market rallies are commonplace. The main difference with this one was its speed. It still does not change the underlying fundamentals. While we agree that this bear market process may complete itself in record-time, we think this will be measured in months, not days.

2. The global economy has effectively been brought to a halt. The shocks to both supply and demand are so great that it is nearly impossible to forecast the impacts on cash flows. Credits will need to re-evaluated, dividend coverages need to be reviewed and share buybacks are likely to be adjusted. Companies taking government loans cannot repurchase their shares until a year after the loan is repaid. Non-financial corporations account for 20% of cumulative equity purchases. This source of demand will be diminished.

3. The spike in unemployment will take its toll on consumer sentiment. This means a reduction in demand across the board.

4. Some companies won't survive which means unemployment may be elevated for a time. Which ones? Why? We're working on it, and we have identified many.

5. Independent of time, bear markets need to fulfill a process of backing and filling to define a base. The number of exceptions to this since the Civil War can be counted on one hand. Time spent performing this process can be quite short but typically takes months or even years to complete. The current situation is likely to resolve itself in a very condensed period. For practical purposes we would guess 2-3 months seems reasonable at this time.

For the time being, cash positions are elevated and we expect them to remain so until a clearer picture unfolds. We have a long list of companies that we think are attractively priced and are queued up for purchase. Our equity selection process has always thought of growth as being but one of several components of value. The cost of acquiring growth has been adjusted downward and this will result in additional changes in holdings to reflect this new reality.

Once we think a bottom has completed, we expect to purchase many of these at ½ the normal weight. This will give us the opportunity to increase our holdings and still maintain flexibility to cope with additional volatility, should it occur.

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, or the undersigned or go to SEC.GOV.

We appreciate the opportunity to be of service to you especially during this crisis. Please call us anytime to talk, particularly if you have any changes in your goals, lifestyle, or your health. We are the Arbor Capital family and we are here for you.

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 3, 2020**

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