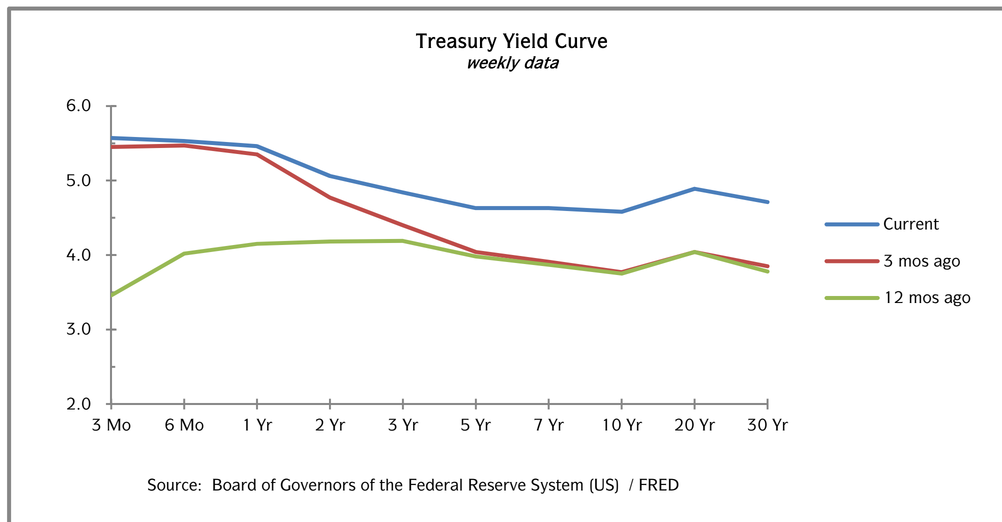
Arbor Capital Management

A Pure Asset Manager

Fourth Quarter 2023 Investment Overview

So far this year, the financial markets and the economy have been a bit of a puzzle. Historically reliable indicators don't appear to be working. Opinions and thoughtful analysis run the whole gamut of possible scenarios for the next twelve months. There is minimal market consensus, in our opinion. In this quarter's commentary, we will highlight what is known and how we intend to manage it.

Inflation and Interest Rates. There has been a lot of discussion about inflation over the past year. The best indicator of inflation expectations that we know of is the yield curve. One picture is worth one thousand words.



Twelve months ago, interest rates reflected expectations that inflation would remain steady as far as the eye could see. Since then, the Fed has steadily raised rates, roughly keeping pace with rising inflation. Three months ago, inflation was perceived as elevated, with a prospect of a rather sharp decline within one year (normal recession). Therefore, the yield curve inverted (short-term rates greater than long-term rates). Currently, interest rates reflect the same short-term inflation as three months ago, but expected inflation in the future is higher than three months ago (shallow recession with stubborn inflation). The current yield curve is consistent with the Fed's statements that monetary policy may need to tighten and is likely to remain more restrictive for longer than many may think. Looked at another way, inflation is expected to persist near current levels.

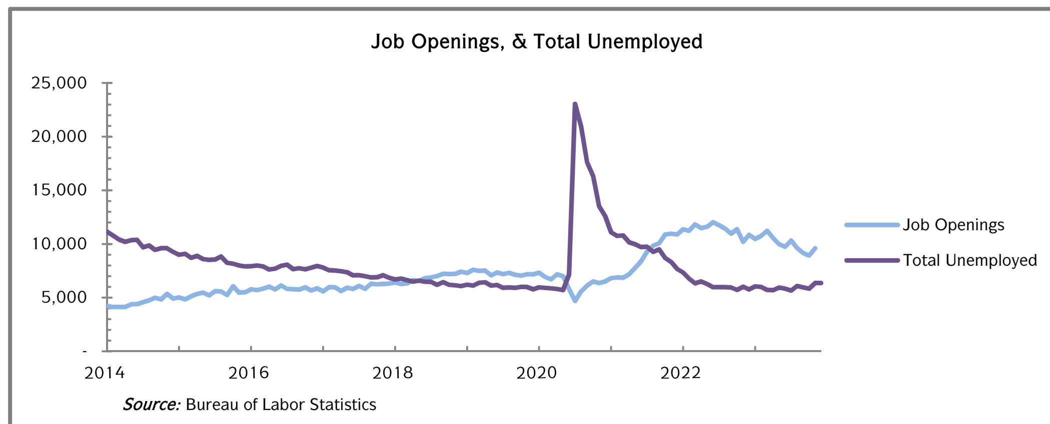
Further, any recession we may have is expected to have little effect on reducing inflation pressures (i.e., a mild recession). For the Fed to achieve its target inflation rate of 2-2 ½ percent, they may

have to continue raising rates into next year. Bond market reactions shown by shifts in the yield curve are an excellent barometer of Fed policy moves.

The economic analog to interest rates is employment. Historically, the Fed would raise rates, people lost jobs, consumer spending shrunk, and inflation decreased. Then, the Fed would reduce rates, and growth could resume anew. The current labor market has added a few wrinkles, namely, multiple job holders and a massive increase in retirements. If one holds two jobs and gets furloughed from one, they are still employed. Their earnings, however, took a blow.

In contrast, the baby boom generation is entering its peak retirement phase over the next few years. They still comprise over 22% of the population and are generally far better off than their parents. Retirees are unaffected by job losses since their income is from pensions and savings. These factors alter the relationships between interest rates, unemployment, and inflation. Interest rate hikes may not be as effective in combating inflation as in previous economic cycles.

At this time, we think a better metric of job market conditions is comparing Job Openings and Total Unemployed.



As long as openings are greater than the number of prospective hires, there is a tendency toward tight labor market conditions, underscoring the prospect of longer and tighter Fed policy.

Fixed Income. We are still emphasizing short-term bonds but gradually extending maturities to capture the best possible combination of interest rates and relative safety. Our credit criteria remain high. Should an issuer suffer a downgrade to Baa, any issues we hold become a source of funds for probable replacement depending on practical considerations on a case by case basis.

Equities. Share prices are in a general state of correction. Cash positions are elevated at this time. Our primary focus has been on companies whose sales and earnings are indifferent to economic events. Most of these are excellent businesses whose products you are familiar with. We intend to keep most of them. Going forward, we expect to increase emphasis on earnings and dividend growth for the next economic cycle. The structure we envision will resemble a barbell with the largest proportion in our core names, with an increasing proportion allotted to improving earnings and/or dividend prospects.

Clients with taxable accounts will find your Realized Gain and Loss Statement through the first three quarters of 2023 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 or require a distribution from your IRA, please notify us prior to December 1, 2023 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 23, 2023

Chief Investment Officer

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

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