



Arbor Capital Management

Third Quarter 2017 Investment Overview

Most people would likely agree that the economic cycle and the financial markets are extended. Conditions have been and continue to be moderately positive and each can continue to progress gradually. We are optimistic that these trends remain in place, barring some exogenous shock. The trend of growth continues to be stuck around 2-3%. Labor, Home Prices, Capital Spending are firming which suggests some possibility of acceleration of economic growth in 2018.

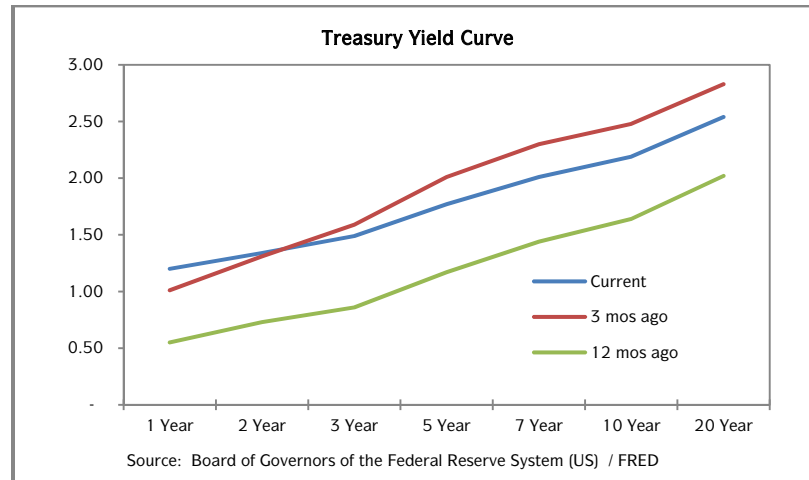
The unemployment rates continue to decline toward 4%. This is generally associated with full employment, but as we have said in the past the number of discouraged and underemployed workers is quite large. Still the progress is clearly positive as any firming in worker demand creates opportunities for job seekers. At the current pace of job creation, we anticipate some cost push inflation gradually working in to something like 2% over the next 2 years or so.

Home prices have been bolstered by a combination of low interest rates, financial stability and job growth. After eight years of recovery, aggregate home prices have recovered to their pre-recession levels. This brings with it a “wealth effect” that drives consumer confidence higher. Intuitively, this should lead to greater consumer spending though empirical evidence of this phenomenon is difficult to measure.

Capital goods production is in the midst of a favorable upturn after a pause over the past two years.

International trade relationships are in the process of being restructured in significant ways. President Trump is taking a fresh look at our foreign trade policy and agreements which historically have been overly generous. Some are simply obsolete and need to be more reflective of today’s conditions. Large regional agreements are difficult to maintain and/or enforce and are expected to be replaced by bi-lateral agreements. Bad actors can easily hide behind the safety of numbers. Once they are held to account on their own actions economic behavior is expected to change for the better. Clearly, there will be winners and losers in this transition and emerging market economies are most impacted either positively or negatively. Alliances will be realigned to groupings that are more natural fits. Ultimately, this should be additive to US GDP growth and for America’s favored trade partners.

The Federal Reserve minutes underscore the slow growth scenario with little to moderate financial risk. As employment improves and GDP grows we can expect a fairly steady pace of gradual rate increases. Bond yields are higher than last year but a little below last quarter. It appears that some traders expected far more rapid policy movement from Congress than actually took place and prices are adjusting. The yield curves below illustrate this point. After the election, inflation expectations picked up which explains the increase in overall rates and the steepening of the yield curve. After it became apparent that change was not going to be so rapid, rates at the long end dropped while the Fed's rate increases caused the very short end to rise.



Accordingly, our strategy in fixed income is to reduce risk by structuring portfolios in very high quality and a bit shorter than intermediate maturity benchmarks. We add value through security selection by seeking the best possible values relative to risk. To reduce risk, we may use step-ups or floating rate securities. Taxable fixed income accounts may also see some representation in taxable municipals that generally have stronger credits than many corporates and are priced more attractively. Where tax exempt income is warranted we will, on occasion, purchase bonds with stated maturities a little longer than usual but with a high coupon. When this is done the Yield to Call is greater than a current coupon instrument with the same credit. Using these techniques we are striving to preserve principal and add the greatest possible value to your portfolio.

Equities are fairly valued in absolute terms. P/E's and other measures are at the upper ranges of historic norms. However, relative to bonds they are more attractive. We will be tilting equity holdings slightly toward value as opposed to growth in order to adjust to this environment. We have been adding to the Financial Sector. We think Energy shares have been beaten down and there are a number of good values going forward. The US will soon be exporting liquid natural gas (LNG) primarily to Eastern Europe who currently rely on Russia almost exclusively for this resource. Companies rich in gas reserves should see an improved secular outlook. Of course, corrections can happen at any time and they take various forms. Sometimes an extended period of time moving sideways is sufficient to restore market equilibria. We think the flat market behavior of the past several months may have accomplished some of that.

The continued response to our website has been overwhelming. If you have not had an opportunity to visit www.arborcapitalmgt.com, we invite you to tour the site. We hope you are enjoying “Financial Insights” our email video series on a variety of financial topics. We welcome your comments and suggestions for new topics to discuss.

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

July, 2017

Chief Investment Officer

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

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