LIBERTY CAPITAL MANAGEMENT

QUARTERLY OUTLOOK

Vol. XXV - Number 4 Fourth Quarter 2017

The Economy

Fed Policy—The Next Phase

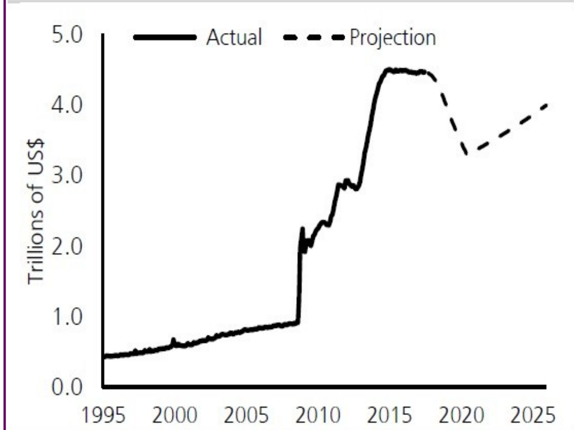
We knew it was coming. It was inevitable. The Federal Reserve Board has finally announced plans to reduce its humongous balance sheet.

In the old days, say ten years ago, the Fed's balance sheet was a non-issue and well under the radar of Fed watchers and investors. The financial crisis and Great Recession in 2008-2009 changed that. The Fed was compelled to aggressively support the financial markets by buying and holding billions and billions of Treasury- and mortgage-backed securities. The nearby chart clearly shows the explosion of balance sheet assets from 2010 through 2015. The total is now $4.5 trillion ($4,500,000,000,000!).

The current plan calls for a monthly reduction of $6 billion in Treasury-backed securities and $4 billion in mortgage-backed securities. Reductions will gradually accelerate each quarter until they reach $50 billion per month in about a year. While those are really big numbers, they barely put a dent in the total, which only falls to $3.3 trillion over the next three years. The program began in October.

The Fed obviously feels the economy is strong enough to absorb this policy change. Interest rates are likely to increase affecting borrowing costs across the economic landscape. Although the plan has been widely anticipated, there is still the risk and worry that investors and

Figure 1: We expect the balance sheet falls to $3.3 trillion



Source: Federal Reserve; UBS

the economy will react adversely to higher rates. Keep in mind, the Fed's plan to nudge short-term rates higher remains in place. There have been two increases so far in 2017, and another is anticipated when the Fed meets in December. Many experts are predicting two or three more quarter point hikes in 2018.

So is the economy strong and resilient enough to sustain itself through the coming headwinds? The answer, of course, is good news and bad news. The good news is the second-quarter growth reflected healthy acceleration from the first quarter. The January-to-March period produced lackluster growth of only 1.2 percent (annual rate). Growth in the second quarter jumped to a 3.1-percent annual rate, the strongest growth since the first quarter of 2015.

The massive damage caused by Harvey, Irma, and Maria, the back to back to back hurricanes that battered Southeast United States and Puerto Rico, is the dark cloud over the growth scenario. Analysts believe the economic disruption could rival that of Hurricane Katrina, the most expensive natural disaster in history. Early estimates put the damage around $167 billion, equating to 1.2 percentage points of GDP growth in the quarter. As the impacted areas are rebuilt, it is uncertain if that can be reclaimed in subsequent quarters.

To sum it up, the economy is in good shape. Unemployment is roughly 4.3 percent and likely to drop moderately over the next two years. Real Gross Domestic Product growth is forecasted to hover around 2.0 percent and inflation is targeted at 2.0 percent. The Goldilocks Economy is alive and well.

"Growth in the second quarter jumped to a 3.1 percent annual rate, the strongest growth since the first quarter of 2015."

Fixed Income

Tax Proposal Impacts

Bond Markets

In September, a continued uptrend in the Fed funds rate created negative returns throughout the bond markets. In most sectors, the longest maturities recorded the poorest returns.

Despite a bad September, the year-to-date returns for fixed income remains positive. Intermediate term corporate bonds have returned 3.42% to investors. The municipal bond market continued to outperform corporate bonds. The intermediate-term municipal bond index has returned 3.85% and the long-term municipal bond index has returned 5.96% as of September 30, 2017.

Trump's Tax Proposal and Its Impact on the Municipal Bond Market

After several head fakes, the White House has unveiled a starting point for tax reform. Contrasting other areas–healthcare, immigration, a wall–this looks like it might actually happen. So let's take a look at ways tax reform may impact the municipal bond market…IF Congress ultimately enacts it.

The Decreased Demand Argument

You will hear arguments and theories that if tax rates are lowered for the wealthiest individuals, demand for municipals bonds will decrease, causing prices to decline. Thus far, prices are up since Trump won the election. Why is that?

Investors in higher tax brackets benefit from municipal bonds because interest payments on municipal bonds are often exempt from federal income taxes, as well as the 3.8% tax on net investment income as part of the Affordable Care Act. In addition to federal tax benefits, most municipal bonds purchased in an investor's home state are also generally exempt from state and local income taxes. When you factor in the potential tax benefits, you may receive a better yield with municipal than with comparable taxable bonds.

The planned cut in the top-rate—from 39.6% to 35%—is simply too small to decrease the demand for municipal bonds. If a top-bracket individual losses some of their tax deductions, they could minimize their taxes by demanding more tax-exempt municipal bonds, not less.

Impact from High-Tax States

The Trump proposal would no longer allow Americans to deduct state and local taxes from their federally taxable income. Historically, this is a major deduction for residents with high taxes and property values in states such as New York, California, and New Jersey. That may prove beneficial for municipal bond holders as residents continue to pursue tax shelters. Here's how:

If deductions for state and local tax as well as mortgage interest goes away, the effective tax rate of a top tax bracket individuals could easily drift up, not down. If this happens, the demand for municipal bonds would actually increase.

> *"Remember congress, not the President, sets tax policy…"*

AMT Elimination

The Trump plan also calls for the elimination of the Alternative Minimum Tax (AMT). Back in 1982 when the AMT was enacted, the bill mandated that income from certain private-activity municipal bonds had to be included in the calculation of the AMT. In other words, income from AMT bonds would be taxed greater. Because of this, AMT bonds typically have a higher yield than non-AMT municipal bonds. To simplify, eliminating the AMT would: 1) Reduce the yields of AMT bonds. 2) AMT bonds would trade closer to general municipal bonds. 3) This would result in prices of AMT bonds going up… because as yields come down, prices go up.

Bottom Line

Remember congress, not the President, sets tax policy. Therefore, the final outcome may be different from what President Donald Trump's administration initially proposed. We do not advocate trading based on potential policies coming out of Washington.

Liberty Capital Management's approach of maintaining a fixed income portfolio with reduced sensitivity to changes in interest rates positively contributes to our fixed income philosophy. We continually monitor the bond markets, seeking anomalies that will provide opportunities to our clients' fixed income portfolios.

Equity Markets

Hurricanes Can't Blow the Market off Course

Another quarter with the market reaching new highs comes to a close. The Year-to-date returns for the DJIA, S&P 500, and NASDAQ indices 13.37%, 12.53%, and 20.67%, respectively.

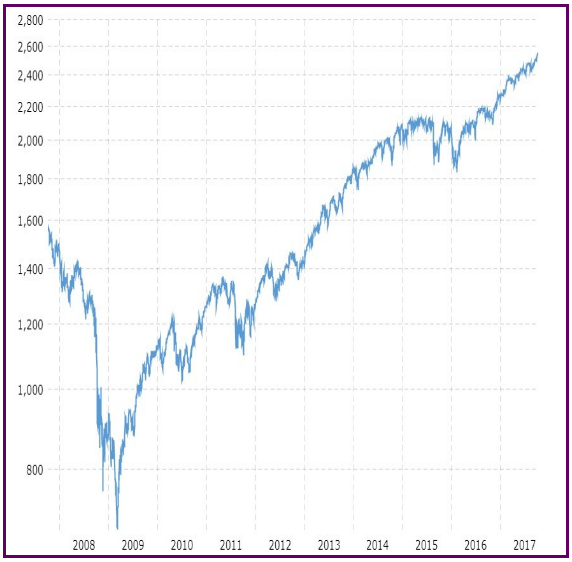
Three hurricanes were not enough to slow the stock market in the third quarter. We saw a short-term hit to the GDP but the market has just paused and then moved to new highs. There has been some sector rotation into technology, then back out, and then back in. Oil was heading up but then it retreated. The next event that would move the market is a tax deal. Washington would love a victory before the year-end and everyone would like lower tax rates for individuals and corporations.

There continues to be slow yet steady economic growth. The Federal Reserve continues to be relatively accommodating even though they have begun to shrink their massive balance sheet. Unemployment is low (4.4%), and we haven't seen much wage inflation. Interest rates are still low (10-year Treasury note is at 2.35%), and corporate earnings continue improving. Not even the lack of partisanship in Washington DC can affect this market.

A few facts to consider:

- The S&P 500 has been positive (on a total return basis) for 11 consecutive months and 18 out of the last 19.
- There hasn't been a 3% pullback in the S&P 500 since last November, the second longest time period in history.

- The S&P 500 is on pace for the 9th consecutive up year, tying the run from 1991-99.



Source: macrotrends.net

"The S&P 500 is on pace for the 9th consecutive up year."

As we have reiterated for the last few issues, while we remain fully invested, we still foresee a market correction of at least 10% over the near term. Also, note that a market correction is just that—it corrects market pricing inefficiencies. It does not alter corporate profit growth; it does not alter economic growth, employment trends, or consumer consumption. It simply corrects pricing which makes the market more efficient and allows the bull market to continue.

At some point, earnings stall, unemployment rises, inflation becomes worrisome, and markets fall. While this current bull market is certainly "long in the tooth," we do not see this economy and the markets falling off a cliff anytime soon.

The long-term time horizon to investments is what best serves our portfolios. Trying to time when to get in or out has never been a good approach. A market correction should be viewed in the context of an ongoing cyclical bull market.

By the Way…Compliance Issues

Custodial Statements

As you know Liberty Capital Management is your investment advisor and another financial services firm handles the custody of your assets. It may be Charles Schwab, TD Ameritrade, UBS, Comerica or other financial institution. We have access to copies of these statements, but it is important for you to receive them as well. If you are NOT receiving statements from that financial institution on a regular basis you should contact them directly.

Charles W. Brown ~ Kenneth J. Carbaugh ~ Charles L. Dettloff ~ Robert D. Foster

Focus On . . .

Health Care Services Group, Inc. (HCSG)

Healthcare Services Group, Inc. provides management, administrative and operating services to the housekeeping, laundry, linen, facility maintenance and dietary service departments of the healthcare industry, including nursing homes, retirement complexes, rehabilitation centers and hospitals located throughout the United States. The Company operates through two segments: housekeeping, laundry, linen and other services (Housekeeping), and dietary department services (Dietary). Its housekeeping service involves the management of a client's housekeeping department, which is responsible for the cleaning, disinfecting and sanitizing resident rooms and common areas of a client's facility. Its dietary services consist of managing the client's dietary department, which is responsible for food purchasing, meal preparation and providing professional dietitian services, including the development of menus that meet the dietary needs of residents.

The company (HCSG) has attained a growth rate of 16% over the past 5 years and is expected to continue to grow by 11% over the next 3-5 years. It boasts a solid ROE of 17% despite a low debt to capital ratio. This stock provides stability and quality in a market that has grown more volatile in recent years.

Healthcare Services Group

HEALTHCARE SERVICES GROUP INC
3220 TILLMAN DRIVE SUITE 300
BENSALEM PA 19020
PHONE: 1(215)938-1661
www.hcsgcorp.com

Oct 04, 2017	**$54.61**
Total Return - YTD	40.85%
Dividend Yld	1.38%
P/E	49.20

Capitalization

% LT Debt to Total Cap	.00%
Owned by Institutions	92.60%
Market Capitalization ($Mil)	$3,997
Avg Daily Vol (Last 30 Days)	436,289

Business Overview

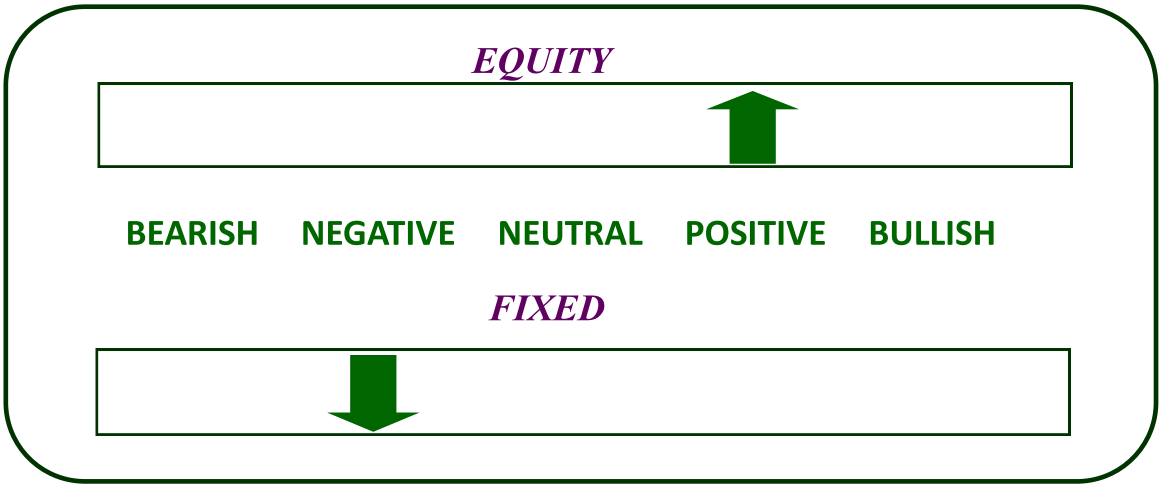
BRIEF: HEALTHCARE SERVICES GROUP, INC. provides management, administrative and operating expertise and services to the housekeeping, laundry, linen, facility maintenance and dietary service departments of the health care industry, including nursing homes, retirement complexes, rehabilitation centers and hospitals located throughout the United States. Based on the nature and similarities of the services provided, their business operations consist of two business segments (Housekeeping and Dietary). We believe that we are the largest provider of these services to the long-term care industry in the United States, rendering such services to approximately 2,900 facilities in 47 states. They provide their Housekeeping services to essentially all the approximately 2,900 facilities and provide Dietary services to approximately 600 of such facilities. Although they do not directly participate in any government reimbursement programs, their clients' reimbursements are subject to government regulation. Therefore, they are directly affected by any legislation and regulations relating to Medicare and

Earnings	**$**		**%**	**Growth Rates**
				5 Yr Historical
Latest Quarter	$0.30	up	15.38%	
Latest 12 Months	$1.11	up	29.07%	%
Zacks Concensus				**LT Future**
Current Quarter	$0.31	up	19.23%	
Current Fiscal Year	$1.25	up	19.05%	11.00%
Next Fiscal Year	$1.45	up	16.00%	
Revenues				**5 Yr Historical**
Latest Quarter	$404 Mil	up	5.12%	
Latest 12 Months	$1,582 Mil	up	7.91%	10.84%
Dividends				**5 Yr Historical**
Indicated Rate & Yield	$0.76		1.38%	
Increases Last 5 Years	19.00			2.86%

Key Ratios & Measures	**5 Year Range***	**Current**
P/E	-	49.20
Price to Book	6.29 - 9.40	10.78
Price to Cash flow	26.35 - 237.76	277.21
Price to Sales* (5yr Avg)	1.74	2.42
Return on Equity* (5yr Avg)	18.04	24.12%
BETA S&P 500		.74

Liberty Capital Management

MARKET BAROMETER



- To sum it all up the economy is in good shape. Unemployment is roughly 4.3 percent and likely to drop moderately over the next two years. Real Gross Domestic Product growth is forecast to hover around 2.0 percent and inflation is targeted at 2.0 percent. The Goldilocks economy is alive and well.

- Choosing the appropriate asset allocation for your needs and staying the course is always the right answer no matter how rough the waters get. Liberty Capital Management's approach of maintaining a fixed-income portfolio with reduced sensitivity to changes in interest rates positively contributes to our fixed-income philosophy.

- Remember congress, not the president, sets tax policy, and the final outcome may be different from what President Donald Trump's administration initially proposed. We do not advocate trading based on potential policies coming out of Washington. .

~ Closing Figures as of September 30, 2017 ~

DJIA	**22409**	**10 yr. Treas.**	**2.33%**	**Funds Target**	**1.00% - 1.25%**
S&P 500	**2519**	**3 mo. T-Bill**	**1.05%**	**Prime Rate**	**4.25%**

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