LIBERTY CAPITAL MANAGEMENT

QUARTERLY OUTLOOK

Vol. XXVI - Number 2 | Second Quarter 2018

IN THIS ISSUE …

THE ECONOMY

Tariffs: "Good" and "Bad"

So far in 2018, the stock market has experienced exceptional volatility whenever the word tariff hits the headline news. So, with tariffs being the topic du jure, we are including it in this edition of Liberty Capital Management's quarterly outlook. Let's first define what a tariff is and then outline how they affect the economy—good and bad.

What is a Tariff?

A tariff is trade protectionism, a type of policy that limits unfair competition from foreign industries. It's a politically motivated, self-protective measure. Five strategies can be implemented: Tariffs, Quotas, Exchange Controls, Export Subsidies, and Voluntary Export Restraints. Other lessor-used measures are administrative obstacles, health and safety standards, and environmental standards. But let's focus this article on tariffs.

Webster Dictionary defines a tariff as "a tax on imports or exports." Money collected under a tariff is called a duty or customs duty. Governments use tariffs to generate revenue or to protect domestic industries from competition. There are generally two types of tariffs. Ad valorem tariffs are calculated as a fixed percentage of the value of the imported good. When the international price of a good rises or falls, so does the tariff. A specific tariff is a fixed amount of money that does not vary with the price of the good. In some cases, both the ad valorem and specific tariffs are levied on the same product.

Until World War I, the tariff was the main source of federal revenue in our country. The United States, which has lower tariffs than most other countries, charges less than 5 percent of the value of most imports.

The "Good" Argument

- **Reduce Deficits:** Free trade can create enormous national deficits. Tariffs can help close the gap.
- **Increase Revenue:** Tariffs increase revenue for the government imposing them, and the government receives the proceeds of a tariff.
- **Hire Locally:** Protectionism temporarily creates jobs for domestic workers. The protection of tariffs, quotas, or subsidies allows domestic companies to hire locally.
- **More Jobs:** Tariffs ensure jobs in first-world countries can be protected from cheaper labor costs in poorer countries. Generally speaking, protectionism creates more jobs and higher wages at home. Free trade outsources jobs abroad and lowers wages. A tariff is essentially designed to redistribute income from one group of citizens to another.
- **Close the Gap:** Although globalized free trade promises benefits for all, the theory is that the benefits are actually spread unevenly with some individuals making out much better than others. Tariffs and protectionist policies can help to close the gap in income inequality. Most benefits of a tariff ends when the other country retaliates with their own tariffs.

> ***"The benefits of a tariff end when the other country retaliates."***

The "Bad" Argument

- **Price Increases:** A tariff places a tax on foreign imported goods brought into the U.S., making these goods more expensive. Imposing a tariff causes domestic prices to rise, which reduces the domestic quantity demanded and increases the domestic quantity supplied, thereby reducing imports.
- **Expense of Others:** Protectionism in the form of tariffs, quotas, and other trade barriers often benefits one sector at the expense of others.
- **Tradeoff:** Tariffs tend to force a tradeoff between workers and consumers.
- **Potential Trade War:** Other countries usually retaliate. When trading partners retaliate with their own tariffs, it raises the cost of doing business for exporting industries.
- **Discourages Competition:** Tariffs protect local companies from competition with other foreign companies. While this helps in building local companies, it also eliminates competition, but competition is healthy in the provision of quality and cheap products for the consumers.
- **Reduction of Quality of Goods and Services:** When countries impose tariffs on goods from other countries, they reduce competition within that country. By reducing competition, it means that local producers will stop producing quality goods and services.

Final Thought

Free trade is the opposite of protectionism. Free trade is one of the cornerstones of economics. Economics is all about the efficient allocation of resources, so why not apply this efficient allocation beyond national boundaries. International trade helps every country; we all have higher standards of living because of it. If we can remove tariffs and other form of protectionism, we will all be better off.

As Henry Hazlitt wrote, "In the century and three-quarters since Adam Smith released The Wealth of Nations, the case for free trade has been stated thousands of times, but perhaps never with more direct simplicity and force than it was stated in that volume." In general, Smith rested his case on one fundamental proposition: "In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest," Smith continued, "that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question, had not the interested sophistry of merchants and manufacturers confounded the commonsense of mankind."

Fixed Income

Transparency Is A Good Thing

When we sent our previous newsletter in January, the 10-year Treasury note was 2.41% with almost no change for most of 2017. The 10-year Treasury now stands at just under 3.00%. While that is a fairly large increase in yield in a short period of time, it hasn't caused much of a stir in the fixed-income markets. Many fixed-income professionals speak of doom and despair if the 10-year Treasury moves above the magical 3.00% number. However, there is a balance between equities and fixed-income securities that favor bonds as rates slowly increase. Those forces have been in place the last year or so, and we expect that to continue for a while. Another example of this change is the dividend yield on the S&P 500 compared to the yield on the two-year Treasury notes. The two-year notes, with a 2.27% yield, now have a higher yield than the dividend yield on the

“No one seems to like surprises especially the stock and bond markets.”

investors S&P 500—this hasn’t happened in almost 10 years!

One reason equities have continued to perform positively as interest rates increase is the Federal Reserve’s transparency. In the Fed’s recent meeting, they increased the short-term funds rate by 0.25%. They were also forthcoming with information on additional rate increases during 2018 as well as in 2019. No one likes surprises, especially the stock and bond markets. As the Federal Reserve, previously under Janet Yellen and now under Jerome Powell, continues to increase the Federal Funds rate a few more times this year and next, we will see the lack of surprises helps stabilize the marketplace. Expect the 10-year Treasury to move above the magical 3.00% level sometime in the near future. Yet, as long as the Federal Reserve moves with the transparency and the pace they have, don’t expect the market to experience doom and despair.

A common misconception is bonds are only for the very old, very rich, or very conservative investors. But truth is, bonds are an important component of a strategically balanced portfolio at every stage of any investor’s life. The key to a well-balanced portfolio is asset allocation and diversification. Although equities have had very good returns over the last few years, those returns come with a higher risk element than a portfolio that includes an allocation to fixed-income securities.

There is no hard rule when deciding how much to invest in bonds. Your investment strategy will change over time. Here are questions to ask yourself: How much risk am I willing to take? What will be the impact on my taxes (municipals or corporates)? What are my investment objectives?

If your answers have changed, let us know so we can make the corresponding adjustments to your portfolio.

Equity Markets

In The Midst of The Correction

As we mentioned many times over the last several quarters, a market correction was overdue. This is no longer the case. After a good start in January, the markets began falling and now show the characteristics of a classic correction period. During the first quarter of 2018 the DJIA and S&P 500 indices were down 2.49% and 1.23%, while the NASDAQ was up 2.32 %.

Over the last few weeks, both friends and clients have asked whether they should change the 401k asset mix to hold a higher percentage of fixed income, or if they should sell and go to cash, or if the bull market run is finally over. I have repeatedly stated an emphatic, “NO!” Again, this is a classic market correction. They are swift, they are volatile, and they look scary. Periodically, market prices get lofty and valuations get pushed to more precarious levels. Market corrections bring these extremes back to more normal levels. Think of it as the foam on a freshly poured beer. When you blow away the foam, an enjoyable beverage awaits.

Market corrections are generally defined as a drop in prices of 10% to 20% from the prior high-closing price of the market indices. Additionally, the time to return to a new price high is on average 13 weeks—although the range is plus or minus 7 weeks. Right now, the averages are down approximately 11-12%, and the clock is ticking at 6 weeks. This suggests more volatility is ahead in the near term.

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Did we mention volatility? Large daily and even intra-day price swings are more frequent during corrections. We have seen price swings both up and down of 3% or more on many days.

Adding to this volatility is what the House on Pennsylvania Avenue spews into the Twitter universe. Using social media to attack trade policies and positions on immigration, belittle political advisories on both sides, and even fire your staff is no way to conduct business, let alone run a government.

Not all is doom and gloom. Washington has actually presented us with some positive economic stimulus. The recent tax overhaul package Congress hammered out is already showing up in larger payroll checks for most Americans. American business is looking at lower tax rates and greater leverage in using their foreign profits for reinvestment. We are at near full employment, and wage inflation has been a non-event so far.

Interest rates, while slowly creeping up, are still at historically low levels. The yield on the 10-year Treasury may soon rise above 3% but that is expected. While the Federal Reserve is on track to raise their short-term interest rates through this year and into next, the economy is continuing to improve its rate of growth without noticeable increases in inflation. One of our key indicators to a market's long-term trend is making sure short-term interest rates do not exceed long-term rates. When the yield on the two-year Treasury is higher than the yield on the ten-year, a major red flag is raised. At this point in the economic cycle, we do not foresee this happening for at least a year.

The long-term market trend remains intact. Until we see signs the economy is wavering, we maintain our market forecast.

Eventually market corrections create opportunities. The high flyers came crashing to earth and the laggards have yet to find a base to resume their advance. We analyze our stock universe for companies that have maintained their earning quality and superior performance. If prices are lower due to outside factors such as the current environment, then we may consider purchases for portfolios.

This is truly one of those "two steps forward, one step back" moments. It will pass, and the bull market will resume. Don't let short-term market nerves get the better of you. Maintain the long-term view on your investment portfolio.

By the Way…Compliance Issues

ADV Brochure Offering

As a registered investment adviser, we are required by securities laws to annually furnish you with updated information about our firm, which we detail in our firm's Form ADV Part 2 Brochure disclosure document.

Since the firm's 2017 annual update Brochure, we have made minor updates, but no material changes were made.

If you would like a complete copy of our current 2018 Brochure, you may contact me by email or phone and I will be happy to send you a complete copy free of charge. You may also obtain a copy of the form and other information about our firm from the SEC's Investment Adviser Public Disclosure (IAPD) system at www.adviserinfo.sec.gov.

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

FOCUS ON . . .

CINTAS CORPORATION (CTAS)

Cintas Corporation is a provider of corporate identity uniforms through rental and sales programs, as well as a provider of related business services, including entrance mats, restroom cleaning services and supplies, carpet and tile cleaning services, first aid and safety services and fire protection products and services. Its segments include uniform rental and facility services, and first aid and safety services. Its uniform rental and facility service segment offers services, which include rental and servicing of uniforms and other garments, including flame resistant clothing, mats, mops and shop towels, and other ancillary items. Its first aid and safety service segment offers services, which include first aid and safety products and services. Rental processing plants, rental branches, first aid and safety facilities, fire protection facilities, direct sales offices, distribution centers and manufacturing facilities are all utilized by the businesses included in all Other.

The company (CTAS) has attained a growth rate of 24% over the past 5 years and is expected to continue to grow by 12% over the next 3-5 years. It boasts a solid ROE of 23% despite a low debt to capital ratio. This stock provides the long-term stability and quality that Liberty Capital Management looks for.

Cintas Corporation (CTAS) NqGS

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Apr 04, 2018	**$169.20**
Total Return - YTD	8.58%
Dividend Yld	0.96%
P/E	

Capitalization

% LT Debt to Total Cap	49.81%
Owned by Institutions	66.49%
Market Capitalization ($Mil)	$18,018
Avg Daily Vol (Last 30 Days)	619,944

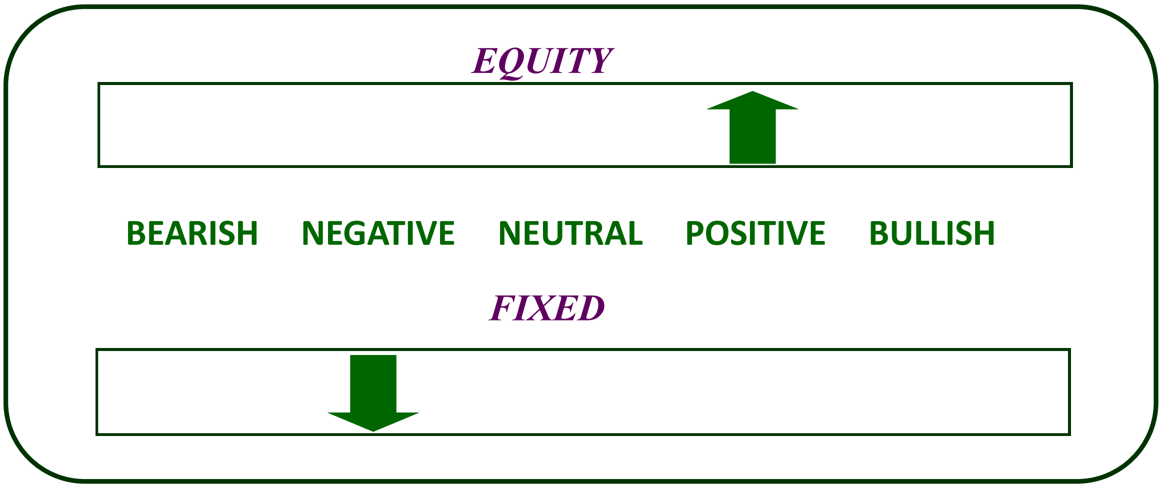
Business Overview

BRIEF: Cintas Corporation provides highly specialized products and services to businesses of all types throughout North America as well as Latin America, Europe, and Asia. Cintas' products and services are designed to enhance its customer's images and brand identification as well as provide a safe and efficient work place. Cintas classifies its businesses into four operating segments based on the types of products and services provided. The Rental Uniforms and Ancillary Products operating segment consists of the rental and servicing of uniforms and other garments including flame resistant clothing, mats, mops and shop towels and other ancillary items. In addition to these rental items, restroom cleaning services and supplies and carpet and tile cleaning services are also provided within this operating segment. The Uniform Direct Sales operating segment consists of the direct sale of uniforms and related items and branded promotional products. The First Aid, Safety and Fire Protection Services operating segment consists of first aid, safety and fire protection products and services. The Document Management

Earnings	**$**		**%**	**Growth Rates**
				5 Yr Historical
Latest Quarter	$2.71	up	110.08%	
Latest 12 Months	$		%	%
Zacks Concensus				**LT Future**
Current Quarter	$1.65	up	54.21%	
Current Fiscal Year	$5.82	dn	-6.28%	12.00%
Next Fiscal Year	$6.98	up	19.93%	
Revenues				**5 Yr Historical**
Latest Quarter	$1,589 Mil	up	24.04%	
Latest 12 Months	$ Mil		%	4.00%
Dividends				**5 Yr Historical**
Indicated Rate & Yield	$1.62		0.96%	
Increases Last 5 Years	4.00			21.32%

Key Ratios & Measures	**5 Year Range***	**Current**
P/E	-	
Price to Book	2.55 - 6.77	7.28
Price to Cash flow	10.24 - 26.20	22.09
Price to Sales* (5yr Avg)	2.05	3.09
Return on Equity* (5yr Avg)	22.90	23.19%
BETA S&P 500		.92

MARKET BAROMETER



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- There is no hard and fast rule when deciding how much to invest in bonds. Your investment strategy will change over time. Here are few questions to ask yourself. How much risk am I willing to take? What will be the impact on my taxes (municipals or corporates)? What are my investment objectives? If some of these answers have changed for you let us know so we can make the corresponding adjustments to your portfolio.

- At some point market corrections create opportunities. As you would expect, the high flyers have come crashing to earth and the laggards have yet to find a base to resume their advance. We analyze our stock universe for companies that have maintained their earnings quality and superior performance and, if prices are lower due to outside factors such as the current environment, then we may consider purchases for portfolios.

~ Closing Figures as of March 31, 2018 ~

DJIA	**24103**	**10 yr. Treas.**	**2.76%**	**Funds Target**	**1.50% - 1.75%**
S&P 500	**2640**	**3 mo. T-Bill**	**1.73%**	**Prime Rate**	**4.75%**

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