LIBERTY CAPITAL MANAGEMENT

QUARTERLY OUTLOOK

Vol. XXVI - Number 4 Fourth Quarter 2018

THE ECONOMY

Let's Choose to Tell a Different Story

The US Economy

We wrote last quarter that the stock market has experienced exceptional volatility whenever the word tariff or "trade war" hits the headline news. The Balance of Trade is literally one of hundreds of economic indicators to follow. It can be overwhelming and confusing for the individual investor. If investors follow more important economic indicators, they can get a good pulse on what is happening in the economy. Let's talk about other economic indicators Liberty Capital Management likes to consider.

Consumer Spending

What is it? Every time you purchase food at the drive-thru or pull out your debit or credit card to buy something, you are participating in consumer spending. Consumer spending is one of the bigger, extremely important concepts in economics because it helps determine the growth and success of the economy. Businesses can open up and offer all kinds of products, but if we don't purchase or consume their products, they won't survive very long! If they don't stay in business, many of us won't have jobs or the income to buy goods and services.

Consumers are, naturally, vital to businesses. The more money consumers spend, the better companies perform. For this reason, it is not surprising that most investors and businesses pay significant attention to consumer spending figures and patterns.

In fact, the American Association of Individual Investors lists real GDP as the most important economic indicator to watch. If consumers provide fewer revenues for a given business or within a given industry, companies must reduce costs and wages, or innovate and introduce newer, better products and services to adjust. Companies that do this most effectively earn higher profits and, if publicly traded, tend to experience better stock market performance.

How is Consumer Spending doing?

This year is a good year for consumer spending. Spending, excluding gasoline and autos, will grow 5.1%, better than 2017's 4.2% pace. Sales of building materials are advancing at a more sustainable 3.2% rate compared with a hot 8.2% in 2017. Sales of all other goods will increase 4.9% in 2018, a step up from 2017's 3.9%—the best gain in seven years. Online sales (think Amazon) will have yet another banner year, growing by 15%, while in-store sales should be around 3.6%, their best showing since 2014.

U.S. Personal Income

What is it? The U.S. Bureau of Economic Analysis (BEA) states personal income is income U.S. residents receive from paychecks, employer-provided supplements (such as insurance, business ownership, rental property, Social Security, and other government benefits), interest, and dividends. (Personal income does not include capital gains from changes in stock prices.)

Personal income largely affects consumer spending. Since consumer spending drives much of the economy, national statistical

“As the consumer goes, so goes the economy.”

organizations, economists, and analysts track personal income on a quarterly or annual basis.

For example, in the United States, the Bureau of Economic Analysis (BEA) tracks personal income statistics monthly and compares it to the previous month. The agency also separates the numbers into categories, such as personal income earned through employment wages, rental income, farming, and sole proprietorship. This allows the agency to analyze how earning trends are changing.

How is U.S. Personal Income doing?
Personal income increased $60.3 billion (0.3 percent) in August according to estimates released by the Bureau of Economic Analysis, which is on pace to do better than 2017.

Schwab Newsroom wrote an article about how the combination of steady economic growth and falling unemployment has been a boon for workers as well as creating a mystery of sorts: Wages have only moderately grown and inflation has been low. On one hand, when unemployment falls below a certain level, many believe consumer prices and wages will start to rise because businesses have to shell out more to hire increasingly scarce workers. On the other hand, the country also would benefit from what market observers have called the Goldilocks economy—neither too hot nor too cold.

The Bottom Line
As the consumer goes, so goes the economy. Consumer spending is likely to advance and remain a mainstay of economic growth. Beyond that, spending growth might be expected to level off somewhat as the boost from the tax cuts fade away.

Fixed Income

Why So Much Corporate Debt?

Many terms are being used recently to describe the Corporate Debt markets: bubble, surge, record-high, and risk. Despite all those seemingly concerning terms, supporting factors may prevent corporate bond prices from falling sharply in the near term.

First, let’s talk about the occurring factors in the corporate bond market. There has been a significant increase in issuance in the last 10 years. The amount of nonfinancial corporate debt has jumped to more than $9 trillion as of the first quarter of this year, and the trend continues to move up. A decade ago, nonfinancial corporate debt was $6.4 trillion. Although a 41% increase may seem large, it aligns with the growth in U.S. gross domestic product, which has been 38% in the same time period. Other factors affecting the issuance of corporate debt are historically low interest rates, a strong economy, less strict borrowing guidelines, and an increased use of debt to fund common stock buyback activity.

Despite the significant increase in debt outstanding, corporations are well positioned to service this debt. Corporate earnings remain strong, the U.S. economy is growing, and corporations generally hold a lot of liquid assets on their balance sheets. According to the Federal Reserve, nonfinancial corporations hold approximately $2.6 trillion in liquid assets on their balance sheets, an 80% increase in the last 10 years. So while the increase in corporate debt has been staggering, the increase in liquid assets of the same companies has been more significant.

The passage of the Tax Cut and Jobs Act at the end of last year has helped

“The amount of nonfinancial corporate debt has jumped to more than $9 trillion.”

boost corporate profits, enhancing the ability to service the additional debt. The drop in corporate tax rates from 35% to 21% and a lower tax on profits repatriated from overseas means there is more cash available to pay down debt or pay interest on the new issuance of bonds. It is still too early to tell what corporations will do with this new found cash flow.

Corporations have also taken advantage of the lower interest rate environment over the last decade. Because of these historically lower rates, companies have issued more debt and for longer average maturity periods. The concern is that at some point the bonds will mature or need to be refinanced. If refinanced, the debt will likely be at much higher rates than when issued.

So what does all this mean for corporate bonds? The greater issuance has not been problematic for companies to adequately handle low interest rates, record profits, and lower tax rates. This is something we will continue to monitor as we watch interest rates slowly rise to traditional levels.

While the 10-year U.S. Treasury note has moved above 3.00% over the last few weeks, the yields on corporate bonds have also moved up. After a long time of low rates, fixed income is finally becoming more compelling. We want to make sure your portfolios are diversified and aligned with your risk tolerance and investment timeframe.

Equity Markets

Too Good To Be True?

After months of corrective action and range-bound prices, the markets delivered a solid quarter for investors. Through September 30, the DJIA, S&P 500, and NASDAQ indices were up 9.00%, 7.20%, and 7.10%, respectively, for the third quarter and are up 7.04%, 8.99%, and 16.56% year to date.

The markets appear in a good position with both household spending and business investment expanding briskly. The overall growth outlook remains favorable. Growth projections for real GDP are 3.1% this year and 2.5% next year. The Tax Cuts and Jobs Act has positively impacted the economy and certainly corporate balance sheets. Businesses are spending their tax savings by investing in research and development, strengthening their balance sheets, rewarding their investors through stock buybacks, and are more willing to increase employee wages.

Fiscal policy is boosting the economy, ongoing job gains are raising incomes and confidence, and overall financial conditions remain accommodative. Households are in good shape because employment is high and wages are slowly growing. Fed Chairman Jerome Powell commented that unemployment should remain below 4% through 2020 and that inflation will stay low, by historical measures, over that period. He is also quoted in the most recent FOMC meeting, “If you look back over the last decade, this is a pretty good moment for the U.S. economy.”

The positive commentary and news suggests this economy is too good to be true. Many are wary of the adage that this bull market will never end, believing the cycle may be at its peak. We are watching some storm clouds on the horizon that may have the potential to negatively affect the markets.

> ***"Both household spending and business investments are expanding briskly."***

Even though the U.S. imposed tariffs on many foreign goods, the U.S. saw its trade deficit continue to widen. This past month's numbers show the imbalance increased by $3.2 billion or 6.4% from August to September. The U.S. export hit the hardest—soybeans—fell $1 billion for the month (sorry farmers). The trade deficit is also up $31 billion year over year. Overall, industrial supplies and materials exports fell $2.4 billion. Food, feeds, and beverages declined $1.2 billion. And consumer goods rose $1.6 billion. On the import side, auto vehicles, parts, and engines increased $1 billion while consumer goods went up $900 million. The effects of tariffs haven't appeared on economic models yet nor have they adversely affected the markets. Although the trade wars have gotten a lot of news coverage, they are not a near-term concern for most investors as they cover less than 1% of U.S. GDP. This, however, could become a greater risk to the economy if tensions do not ease up over the coming quarters.

Another potential concern raised at the last FOMC meeting was the financial crisis of 2008-09. To mitigate risks of the crisis, banks are now forced to do stress testing to combat a similar fate as the last recession. Banks better understand and better manage their risks while maintaining enough capital to survive a substantial shock at least as bad as the 2008 financial crisis. This provides investors and the economy in general the confidence to consume, spend, and invest where they see fit.

This is a time for investors to remain humble and diligent with the markets, while staying patient and committed to their strategies. These key factors lead to strong and consistent compounded returns while statistically giving investors the best chances for long-term growth. This is the longest bull market we have ever seen. The general consensus is the markets should stay this way for the next several quarters.

We plan to stay committed to our strategy while staying patient in the inevitable ebbs and flows of the 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, T D 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.

Thank You Clients From the Liberty Capital Management Team!

We are very grateful for your business because we realize we wouldn't be here without loyal customers like you. We would just like to say thank you for being a part of our family. We appreciate the many referrals you have sent our way this year. It truly is the greatest form of flattery for us.

Kenneth J. Carbaugh ~ Charles L. Dettloff ~ Robert D. Foster ~ Spencer M. Lendzion

FOCUS ON . . .

ALPHABET INC. (GOOGL)

Alphabet Inc. is a holding company. The Company's businesses include Google Inc. (Google) and its Internet products, such as Access, Calico, CapitalG, GV, Nest, Verily, Waymo and X. The Company's segments include Google and Other Bets. The Google segment includes its Internet products, such as Search, Ads, Commerce, Maps, YouTube, Google Cloud, Android, Chrome and Google Play, as well as its hardware initiatives. The Google segment is engaged in advertising, sales of digital content, applications and cloud offerings, and sales of hardware products. The Other Bets segment is engaged in the sales of Internet and television services through Google Fiber, sales of Nest products and services, and licensing and research and development (R&D) services through Verily. It offers Google Assistant, which allows users to type or talk with Google; Google Maps, which helps users navigate to a store, and Google Photos, which helps users store and organize all of their photos.

The Company (GOOGL) has attained a growth rate of 5% over the past 5 years and is expected to continue to grow by 18.56% over the next 3-5 years. It boasts a solid ROE of 13.55% despite a low debt to capital ratio. This stock provides long-term stability and quality that Liberty Capital Management looks for.

Alphabet Inc. Class A (GOOGL)

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Oct 10, 2018	$1122.18
Total Return - YTD	6.53%
Dividend Yld	n/a%
P/E	48.60

Capitalization

% LT Debt to Total Cap	2.40%
Owned by Institutions	78.73%
Market Capitalization ($Mil)	$329,556
Avg Daily Vol (Last 30 Days)	1,821,639

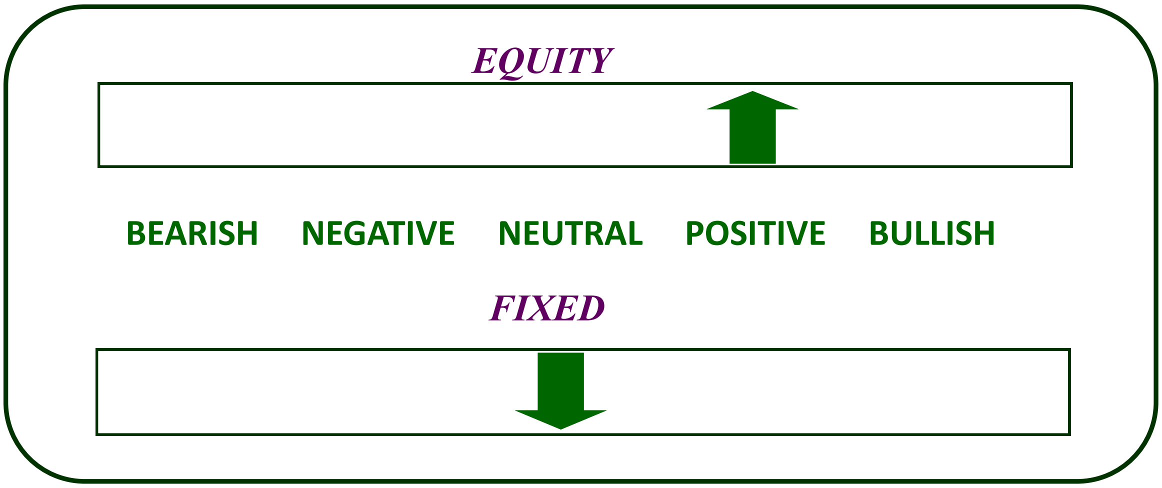
Business Overview

BRIEF: Alphabet, Inc. is a holding company, which engages in the business of acquisition and operation of different companies. It operates through the Google and Other Bets segments. The Google segment includes its main Internet products such as Search, Ads, Commerce, Maps, YouTube, Apps, Cloud, Android, Chrome, Google Play as well as hardware products, such as Chromecast, Chromebooks and Nexus. The Other Bets segment includes businesses such as Access or Google Fiber, Calico, Nest, Verily, GV, Google Capital, X, and other initiatives. The company was founded by Lawrence E. Page and Sergey Mikhaylovich Brin on October 2, 2015 and is headquartered in Mountain View, CA.

Earnings	$		%	Growth Rates
				5 Yr Historical
Latest Quarter	$4.54	dn	-48.99%	
Latest 12 Months	$23.09	dn	-32.80%	%
Zacks Concensus				LT Future
Current Quarter	$10.50	up	9.72%	
Current Fiscal Year	$42.78	up	87.30%	18.56%
Next Fiscal Year	$48.74	up	13.93%	
Revenues				5 Yr Historical
Latest Quarter	$32,657 Mil	up	25.56%	
Latest 12 Months	$124,534 Mil	up	31.73%	16.40%
Dividends				5 Yr Historical
Indicated Rate & Yield	$n/a		n/a%	
Increases Last 5 Years				n/a%

Key Ratios & Measures	5 Year Range*	Current
P/E	-	48.60
Price to Book	1.94 - 4.70	2.72
Price to Cash flow	7.59 - 21.72	10.52
Price to Sales* (5yr Avg)	3.84	3.25
Return on Equity* (5yr Avg)	14.09	9.46%
BETA S&P 500		1.18

MARKET BAROMETER



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~ Closing Figures as of September 30, 2018 ~

DJIA	**26458**	**10 yr. Treas.**	**3.06%**	**Funds Target**	**2.00% - 2.25%**
S&P 500	**2914**	**3 mo. T-Bill**	**2.19%**	**Prime Rate**	**5.25%**

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