LIBERTY CAPITAL MANAGEMENT

QUARTERLY OUTLOOK

Vol. XXVI I - Number 1

First Quarter 2019

In This Issue …

The Economy

The Roles Of The Federal Reserve In The Economy & The Financial System

The Federal Reserve System is the central bank of the United States. It performs five general functions to promote the effective operation of the U.S. economy and, more generally, the public interest. The Federal Reserve:

- **Conducts the nation's monetary policy** to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy

- **Promotes the stability of the financial system** and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad

- **Boosts the safety and soundness of individual financial institutions** and monitors their impact on the financial system as a whole

- **Fosters payment and settlement system safety** and efficiency through services to the banking industry and the U.S. government that facilitate U.S.-dollar transactions and payments

- **Supports consumer protection and community development** through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations

Let's discuss in more detail one of the most important functions.

Conducts The Nation's Monetary Policy

One of the Federal Reserve's most important functions is control of the money supply to avoid severe inflation. The Federal Reserve conducts the nation's monetary policy by managing the level of short-term interest rates and influencing the availability and cost of credit in the economy. Monetary policy directly affects interest rates; it indirectly affects stock prices, wealth, and currency exchange rates. Through these channels, monetary policy influences spending, investment, production, employment, and inflation in the United States. Effective monetary policy complements fiscal policy to support economic growth.

Why is control of the money supply so important? One reason is changes in the money supply seem to affect changes in economic activity. Basically, there seems to be a positive correlation between changes in the money supply and changes in nominal GDP. The implications of these studies indicate if the Federal Reserve can successfully control the growth rate of money (not too fast, not too slow) then it can influence the growth rate of the economy as a whole.

Another important reason for controlling the money supply is when the average prices of a broad collection of goods and services (CPI or inflation) is stable and will likely remain so, changes in the prices of individual goods and services serve as clear guides for efficient resource allocation in the U.S. economy. This then contributes to higher standards of living for U.S. citizens.

"Having the right quantity of money in circulation is crucial to ensure a healthy, sustainable economy."

Moreover, stable prices encourage saving and capital formation. When the risks of erosion of asset values resulting from inflation—and the need to guard against such losses—are minimized, households are encouraged to save more and businesses are encouraged to invest more. Low and stable inflation helps the economy operate efficiently. When inflation is low and stable, individuals can hold money without having to worry that high inflation will rapidly erode its purchasing power. Moreover, households and businesses can make more accurate longer-run financial decisions about borrowing and lending and about saving and investment.

The Bottom Line

The Federal Reserve system works hard to ensure a nation's economy remains healthy. One way the Federal Reserve does this is by controlling the amount of money circulating in the economy. Having the right quantity of money in circulation is crucial to ensure a healthy, sustainable economy.

Can Powell keep the right balance? When he is setting monetary policy, his goal is to keep the inflation rate low and steady. If he does that, then he has done his job in promoting economic stability and the smooth operation of markets.

Fixed Income

So What Is The New Normal?

After suffering through years of historically low interest rates on fixed income securities, the Federal Reserve has steadily increased rates since 2016. The questions on many investors' minds are: For how long will the rate increases continue? And what will rates look like when the Federal Reserve stops? In the last month or so Jerome Powell, Chairman of the Federal Reserve, has often used the phrase *New Normal.* In an effort to clarify the longer-term plan for interest rates, Powell indicated interest rates were approaching normalization; the Fed may only increase interest rates one or two more 0.25% increments.

When we talk about *New Normal* for interest rates, we should look at where we are and where we have been. The 10-year US Treasury note started 2018 at 2.40% and marched steadily higher during most of the year. By November 8, the 10-year note hit the year's highest yield at 3.24%. After November the rate drifted down to about 2.65%. With two more rate increases forecasted for 2019 and no rate hikes for 2020 it is beginning to look like 3.00% may be the *New Normal* for the 10-year Treasury note.

The worst may be over for the bond bear market. After two years of rising bond yields (and falling bond prices) it appears the fixed income market has seen the peak of interest rates for this cycle. Tighter global monetary policy, a strong US dollar, and uncertain equity markets are likely to weigh on economic growth, therefore limiting the rise in bond yields.

As the Fed normalizes rates and continues to reduce its balance sheet, volatility may increase in riskier parts of the fixed income market. The path forward isn't likely to be smooth. When markets adjust to tightening financial conditions, volatility is likely to increase. For fixed income allocation of portfolios, this is a good time to move up the credit quality ladder. It's also a good time to consider some slightly longer maturities as we may have seen the peak on interest rates for this economic cycle. Municipal bonds may post a solid performance in 2019, as demand appears strong for tax-exempt income. The yield differential between corporate bonds and US Treasuries is very small on the short end of the curve.

"With interest rates on fixed income approaching the New Normal, now is a good time to consider the assets allocations in your investment accounts."

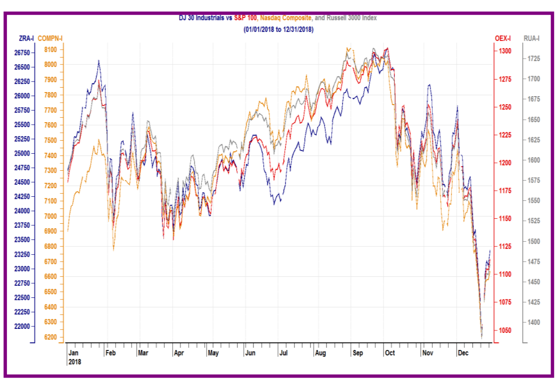
The year's early months are traditionally a good time to review your financial goals, risk levels, and asset allocations. While collecting documents to file 2018 taxes, give some thought to the market changes during 2018 and what the future will bring. With interest rates on fixed income approaching the *New Normal,* now is a good time to consider the assets allocations in your investment accounts.

Equity Markets

This Is What a Correction Looks Like

After writing the previous quarter's commentary in October, we finally rose to new highs since the six-month corrective phase of the market moved to the past. Yet it didn't quite feel right. It was too easy, too complacent of a correction. Remember: corrections are volatile and downright scary. Just three months later, a full-blown market correction is landing in our laps. This is what a correction looks like. But, again, this is a correction, not a recession foretelling bear market. This market has a lot of headwinds to overcome, but economic indicators suggest there is ample opportunity to grow portfolios going forward.

For the record, the DJIA, S&P 500, and NASDAQ indices were down for the year –5.63%, -6.24%, and -3.88%.



The preceding chart gives us a picture of the performance for the major indices over the course of 2018. The chart on the next page tells the story of the major indices since 1991. As you can tell from the 28-year chart, short-term volatility doesn't seem to hinder long-term performance.

The major issues to surmount in order to resume this bull market are:

- **Trade Wars**

There is a big elephant in the room. The various issues between the U.S. and many of its trading partners as well as subsequent tariffs (and threats of more to come) are definitely showing in economic statistics and reducing our growth rate. And it is not just China. Threatened tariffs on European autos, a new trade agreement with Mexico and Canada, and tariffs on Steel and aluminum worldwide also must be addressed. It would be nice if the administration resolved these positions quickly, but that is not likely to happen. The longer these tariffs restrict trade the more damage to GDP growth.

- **The Fed and Other Central Banks**

The era of easy money is gone. The Federal Reserve indicated it would raise rates four times in 2018, and they did exactly that. In the face of slowing corporate profit growth and some cooling in other country economies, only two rate hikes in 2019 should occur. In a growing economic cycle, rates can and do rise and do not forebode a pending recession. The yield curve (difference between the yields of the 2-year Treasury vs. the 10-year Treasury) is key in any impending recession.

- **Slowing Corporate Profits**

Many corporations reaped the plentiful benefits of the tax package Washington passed in 2018. Many of those benefits will not be nearly as much this year. Trade issues, a subsequent increase in the cost of goods, and weaker-than-expected products outside the U.S. has added to a lower profit forecast across the board. But profits are still sound, just growing at a slower pace than last year.

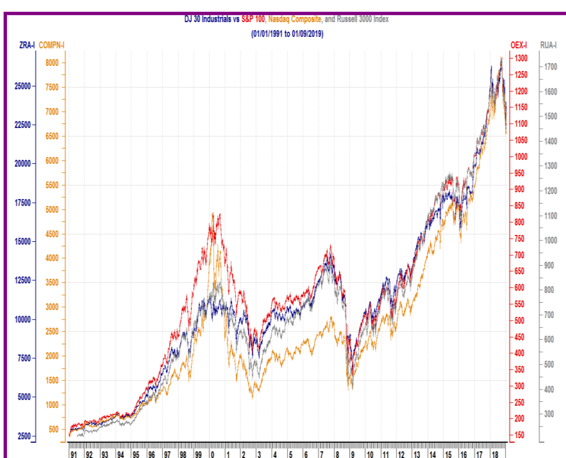
“This bull market is long in the tooth, but it’s not over.”

- **Politics Throughout The World**

Britain continues to stumble through its Brexit plan. Italy is the latest European nation to see a budget crisis because of its government debt. Chinese economic growth is showing noticeable declines, enhanced by the trade war with the U.S. And yes, here in Washington is an amazing display of disruptive politics. I won’t go into the multiple statements, actions, and tweets that spew from this administration, but it seems erratic at best and would be helpful to the markets if a path to achievement could stay on track.

We continue to stay focused on fundamentals through the ups and downs of this volatile market. The data brought forth and released by various companies and economic sources remains the backbone to our investment decisions.

The domestic equity market should resume its rise to new highs over the coming quarters. Current issues will become more focused and corporations, such as those we follow, can adapt to the changing environment. This bull market is long in the tooth, but it’s not over.



By the Way…Compliance Issues

Asset Mix

The asset mix decision, or the ratio of a portfolio’s balance between stocks and bonds is extremely important to the effective management of a portfolio and the client relationship. It is something discussed and agreed upon at the beginning of the relationship and should be reviewed periodically. Situations change: clients age, income becomes more important, time horizons change, etc. Have there been changes in your outlook or situation that should be reflected in your portfolio? Please contact us.

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 . . .

Costco Wholesale Corp (COST)

Costco Wholesale Corporation is engaged in the operation of membership warehouses in the United States and Puerto Rico, Canada, the United Kingdom, Mexico, Japan, Australia, Spain, and through its subsidiaries in Taiwan and Korea. As of August 28, 2016, the Company operated 715 warehouses across the world. The Company's average warehouse space is approximately 144,000 square feet. The Company's warehouses on average operate on a seven-day, 70-hour week. The Company offers merchandise in various categories, which include foods (including dry foods, packaged foods and groceries); sundries (including snack foods, candy, alcoholic and nonalcoholic beverages, and cleaning supplies); hardlines (including appliances, electronics, health and beauty aids, hardware, and garden and patio); fresh foods (including meat, produce, deli and bakery); softlines (including apparel and small appliances), and other (including gas stations and pharmacy).

The Company (COST) has attained a growth rate of 8.43% over the past 5 years and is expected to continue to grow by 10% over the next 3-5 years. It boasts a solid ROE of 26% despite a low debt to capital ratio. This stock provides long-term stability and quality that Liberty Capital Management looks for.

Costco Wholesale Corp (COST) NqGS

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ISSAQUAH WA 98027
PHONE: 1(425)313-8100
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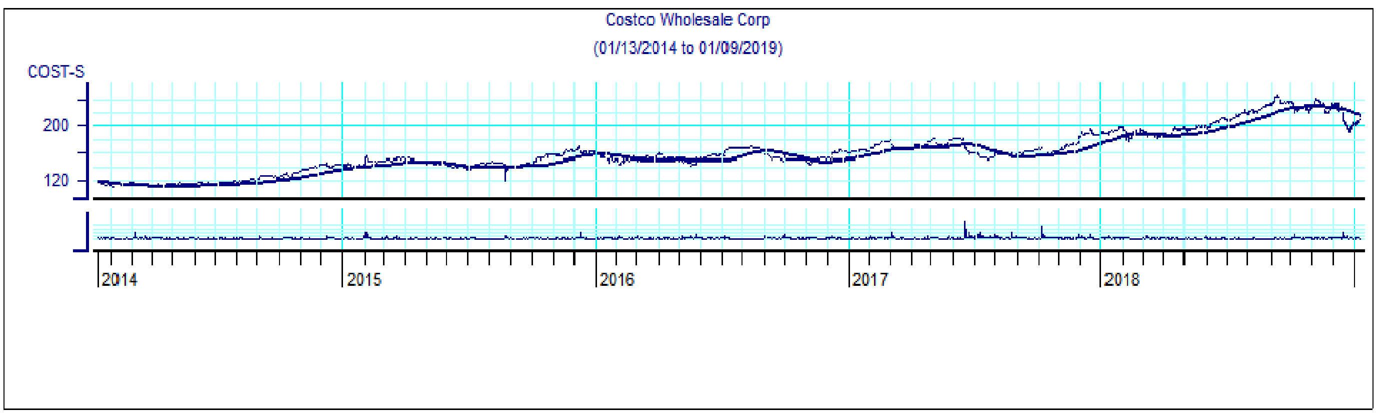
Jan 10, 2019...........	**$210.48**
Total Return - YTD	3.32%
Dividend Yld	1.08%
P/E..................................	28.52



Capitalization

% LT Debt to Total Cap	32.47%
Owned by Institutions	71.59%
Market Capitalization	$92,712
Avg Daily Vol (Last 30 Days)	3,155,595

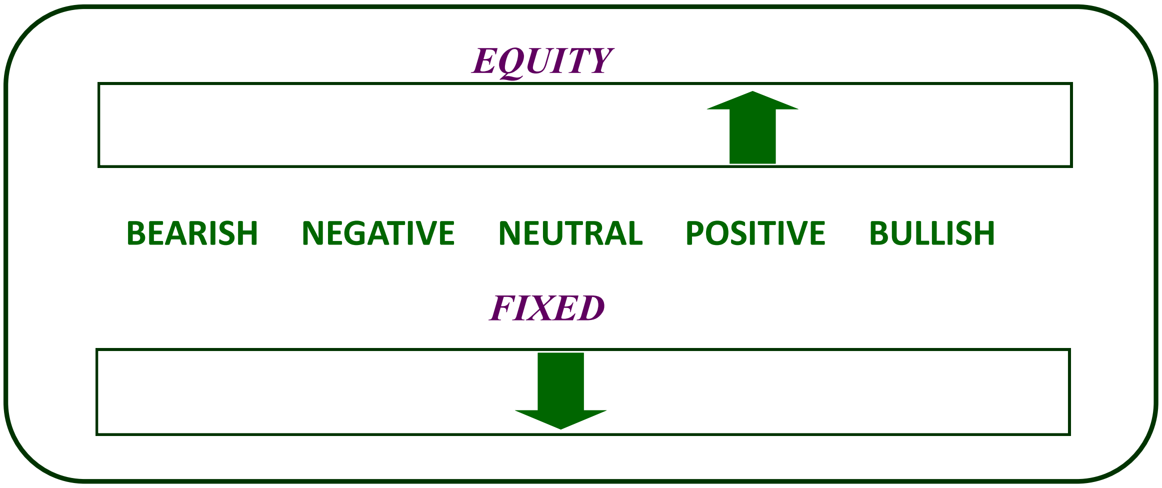
Business Overview

BRIEF: Costco Wholesale Corporation operates membership warehouses based on the concept that offering their members very low prices on a limited selection of nationally branded and selected private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. This rapid inventory turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, enables them to operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets and supercenters. They buy the majority of their merchandise directly from manufacturers and route it to a cross-docking consolidation point (depots) or directly to their warehouses. Their depots receive container-based shipments from manufacturers and reallocate these goods for shipment to their individual warehouses, generally in less than twenty-four hours. This maximizes freight volume and handling efficiencies, thereby lowering their receiving costs by eliminating many of the costs associated with

Earnings	**$**	**%**	**Growth Rates**
Latest Quarter	1.73 up	19.31%	**5 Yr Historical**
Latest 12 Months	7.38 up	17.33%	%
Zacks Concensus			**LT Future**
Current Quarter	1.65 up	3.77%	
Current Fiscal Year	7.64 up	7.76%	
Next Fiscal Year	8.25 up	7.98%	10.00%
Revenues			**5 Yr Historical**
Latest Quarter	35,069 Mil up	10.25%	
Latest 12 Months	144,836 Mil up	9.12%	5.89%
Dividends			**5 Yr Historical**
Indicated Rate & Yield	$2.28	1.08%	
Increases Last 5 Years	4.00		12.47%

Key Ratios & Measures	**Current**
P/E	28.52
Price to Book	6.91
Price to Cash flow	15.67
Price to Sales	.64
Return on Equity	25.88%
BETA S&P 500	.74

MARKET BAROMETER



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~ Closing Figures as of December 31, 2018 ~

DJIA	**23327**	**10 yr. Treas.**	**2.65%**	**Funds Target**	**2.25% - 2.50%**
S&P 500	**2506**	**3 mo. T-Bill**	**2.46%**	**Prime Rate**	**5.50%**

The information and data in this report were obtained from sources considered reliable. Their accuracy or completeness is not guaranteed, and the giving of the same is not to be deemed an offer on our part with respect to the purchase or sale of any securities. Our ADV-Part II Brochure is available upon request or on our website: **www.lcmgt.com**.

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