LIBERTY CAPITAL MANAGEMENT

QUARTERLY OUTLOOK

Vol. XXVIII- Number 4 Fourth Quarter 2020

The Economy
Still No Real Data

Another 3 months have flown by, and economists still have not received any familiar, real economic data. The one thing that is new is the stance on interest rates and inflation as shared by the FED's James Powell.

So, what is the point of keeping interest rates low? What effects do low interest rates cause? Let's examine some of the economic effects of low interest rates:

According to economicshelp.org, lower interest rates make it cheaper to borrow. This tends to encourage spending and investment. This leads to higher aggregate demand (AD) and economic growth. This increase in AD may also cause inflationary pressures.

In theory, lower interest rates will:
1. Reduce the incentive to save. Lower interest rates give a smaller return from saving. This lower incentive to save will encourage consumers to spend rather than hold onto money--exactly what the economy needs right now.
2. Cheaper borrowing costs. Lower interest rates make the cost of borrowing cheaper. It encourages consumers and firms to take out loans to finance greater spending and investment.
3. Lower mortgage interest payments. A fall in interest rates will reduce the monthly cost of mortgage repayments. This will leave householders with more disposable income and should cause a rise in consumer spending.
4. Rising asset prices. Lower interest rates make it more attractive to buy assets, such as housing. This should cause a rise in house prices and therefore in wealth. Increased wealth also encourages consumer spending as confidence should be higher. This is essentially known as the wealth effect, a behavioral economic theory suggesting people spend more as the value of their assets increase. Consumers feel more financially secure and confident about their wealth when their homes or investment portfolios increase in value. They feel richer, even if their income and fixed costs are the same as before.

Lower interest rates are not a guarantee of economic growth. There are other factors affecting growth apart from interest rates.

5. It depends on other factors in the economy. With all else being equal, a fall in interest rates should cause higher economic growth. However, there may be other factors that cause the economy to remain depressed. For example, if there is a global recession then export demand will fall, which may outweigh the small increase in consumer spending.
6. Consumer confidence. If interest rates are cut, people may not always want to borrow more. If confidence is low, a cut in interest rates may not encourage more spending. After 2008, we saw an increase in the savings ratio (despite interest rate cut) this was because confidence fell in the great recession.
7. Time lag. A cut in interest rates can take up to 18 months to affect the economy.

A cut in interest rates will have a different impact on different groups within society.

- **Borrowers aka homeowners (mortgage holders):** Lower interest rates are good news for borrowers, homeowners (mortgage holders). This group may spend more.

“A return to the pre-pandemic unemployment rate of 3.5% seems out of the question”

- **Savers:** Lower interest rates are bad news for savers. For example, retired people may live on their savings. If interest rates fall, they have lower disposable income and so will probably spend less. If a country has a high proportion of savers, then lower interest rates will reduce the income of many people.

Bottom Line

The bottom line is the same as last quarter. Given the gradual nature of the economy opening, we should expect to see a gradual recovery. As more things open, growth should improve in sequence. After all, when you've hit bottom, it's hard to go lower.

Fixed Income

Lower For Even Longer

Last year, when the Federal Reserve started to lower the Fed Funds rate to stimulate a sluggish economy, the phrase “Lower for longer” became the catchphrase for the direction of interest rates. Then, when the effects of the COVID-19 pandemic spread rapidly in March 2020, the Federal Reserve cut short-term rates to zero. Fixed-income investors always want to know how low and for how long. A 0% to .25% target rate for the Fed Funds rate answers the question of how low; now we want to know for how long. The “Lower for longer” phase seems like it was made even longer after the Federal Reserve meeting in late August.

During the August meeting, Fed Chairman Jerome Powell announced a major policy shift, saying: “They are willing to allow inflation to run hotter than normal to support the labor market and broader economy.” The Central Bank formally agreed to a policy of “average inflation targeting.” This means it will allow inflation to run “moderately” above the Fed’s 2% goal. Powell also said, “Many find it counterintuitive that the Fed would want to push up inflation,” indicating inflation that is persistently too low can pose serious risks to the economy. That is quite a contrast to the days of Chairman Paul Volker who ushered through many interest rate hikes to wage a fight against inflation. Now the Fed is trying to create inflation.

Since the end of the financial crisis, the Fed has struggled to hit its 2% inflation target. The hope is that this new approach will change the landscape, raising expectations and allowing inflation to float higher as rates remain low. Chairman Powell declined to specify how much higher he would like to see inflation rise, but most believe 2.5% or higher is necessary to reverse some of the sub 2% years we have had.

So how long is even longer? The Fed did not specify a date or year (it rarely does). Most economists predict a range of inflation between 2.5% to 3% for the next decade. This means the Federal Reserve might not be raising rates for the next 7-10 years. While that time period seems longer than most can believe, keep in mind it took the job market 10 years to recover from the last recession and our unemployment rate currently is much higher now than at the bottom of 2010 when it was 10.6%. Furthermore, the Fed has expressed concern about the impact the Coronavirus pandemic has had on those least able to shoulder it. Although the Fed did not set a specific goal for the unemployment rate, it will enable conditions to dictate what is considered full employment. A return to the pre-pandemic unemployment rate of 3.5% seems out of the question at this point.

Yes, interest rates are low, but the defining features of core bonds (diversification and potential reliable returns) continue to make them a critical component of a well-balanced portfolio. Many portfolios have seen attractive returns even in this low rate environment.

“The S&P 500 has only had the PE Ratio stay above 30 from 1998 to about 2003”

As bonds yields have fallen through most of 2020, the market values have gone up on the fixed-income allocations. Fixed income is generally used to help dampen overall volatility while providing returns that can outpace inflation.

Equity Markets

The Effect of Lower Interest Rates for Asset Prices

The stock market’s rapid rally continues from its March lows and has brought the Nasdaq Composite to record highs. The S&P 500 is now positive for the year.

For the record, the DJIA, S&P 500, and NASDAQ indices were up for the third quarter 8.22%, 8.93%, and 11.02%, respectively, and for the year are –.91%, 5.57%, and 24.46%.

US Federal Reserve Chairman James Powell has said interest rates are likely to stay low for years as the economy fights its way back from the coronavirus pandemic.

For decades, the goal of the US Federal Reserve was to control inflation. Inflation control has now been deemphasized; the main goal is now maximizing employment. This is a huge shift. The US Federal Reserve is very powerful, and now the Federal Reserve is pushing for full employment and using years of zero interest rates as a tool.

Fundamental investment wisdom says: “Don’t fight the fed.” You are supposed to align your investments with Federal Reserve Monetary policy. Buy stocks when interest rates are low, and avoid stocks when interest rates are high.

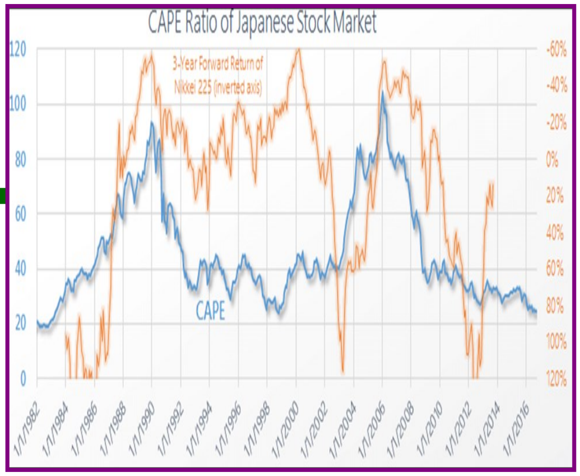
There is and has been an inverse relationship between the stock market’s valuation multiples and interest rates. Ten-year treasury rates have fallen to 0.66%. The central bank now will allow inflation to float above the Fed’s 2% target for a period of time. The Fed no longer will hike rates to head off inflation which historically comes with lower unemployment rates. For the next five years, there will be a zero-interest-rate policy and open-ended quantitative easing (QE). The projections are the 10-year treasury interest rate will stay around 0.6 to 1.0% for 5 years or longer.

Low interest rates and P/E ratios

Brian Wang wrote how many finance papers and financial sites have a regression analysis of the inverse correlation between interest rates and the price-earnings ratio of the S&P 500 stock index.

Some of the calculations using very low-interest rates implied a fair price earnings (P/E) multiple of 150 to 440. Even if the 10-year interest rates were assumed to be 1.5% then the fair price-earnings multiple is 87 to 107. Now, these sorts of calculations are used to emphasize the inverse relationship between interest rates and P/E ratios.

The S&P 500 has only had the PE Ratio stay above 30 from 1998 to about 2003. Japan has had zero interest rates for over 20 years. Japan has not had consistent ultra-high PE ratios after their crash. They did have PE ratios over 60 for 2 extended periods from 1987-1991 and from 2003 to 2008. Multiple years of an index PE ratio at 60 is possible. Nothing is certain, but the Federal Reserve is giving a guarantee of near-zero interest rates for years.



Source: Brian Wang, Nextbigfuture.com

"The end of the year is a good time to assess your financial situation"

Bottom Line

Higher P/E ratios may or may not be justified during James Powell's low interest rate policy for years to come. Financial analysis has never come up short of having opinions from both sides of the equation. No one knows what is going to happen to inflation, interest rates, and P/E ratios. At Liberty Capital Management we are certain staying the course is the best option for investors. We will continue to do that for our clients

Financial Planning

Year-End Items to Consider

With 2020 quickly ending, we have compiled a checklist of year-end strategies to consider before the end of the year. While everyone's situation is different and not every action will apply to you, taking small steps today will lay the foundation for 2021.

Prepare for Taxes. For those of you who do not like surprises, end of year tax planning is a must. Meeting with your CPA and having them run a preliminary projection can help prepare you for any unexpected tax burdens. And, it gives you time to take advantage of tax deductions like charitable contributions.

Harvest Investment Losses. This is likely not the year for losses, at least not for most of you. That being said, every year you should look across your investment accounts where you may realize capital gains to see if you happen to have any investments with losses. Just and FYI, Liberty Capital looks for harvesting opportunities throughout the year.

Review your estate plan. Ensure your overall estate plan, including your will, trust and health care power of attorney, are current.

Review your beneficiaries. Double-check that changes or updates are not needed on your accounts.

Bottom Line: The end of the year is a good time to assess your financial situation. The last day of December is often a significant deadline, so it can make sense to do some year-end housekeeping, including evaluating tax strategies, reviewing estate plans and making plans for the coming year. Of course, tax planning is not a one-and-done end of year exercise. Liberty Capital Management can help align your goals with current tax laws and investment vehicles to generate the most favorable outcome. Reach out to us today if you need to schedule a year-end review meeting.

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.

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

FOCUS ON . . .

DOLLAR GENERAL CORP. (DG)

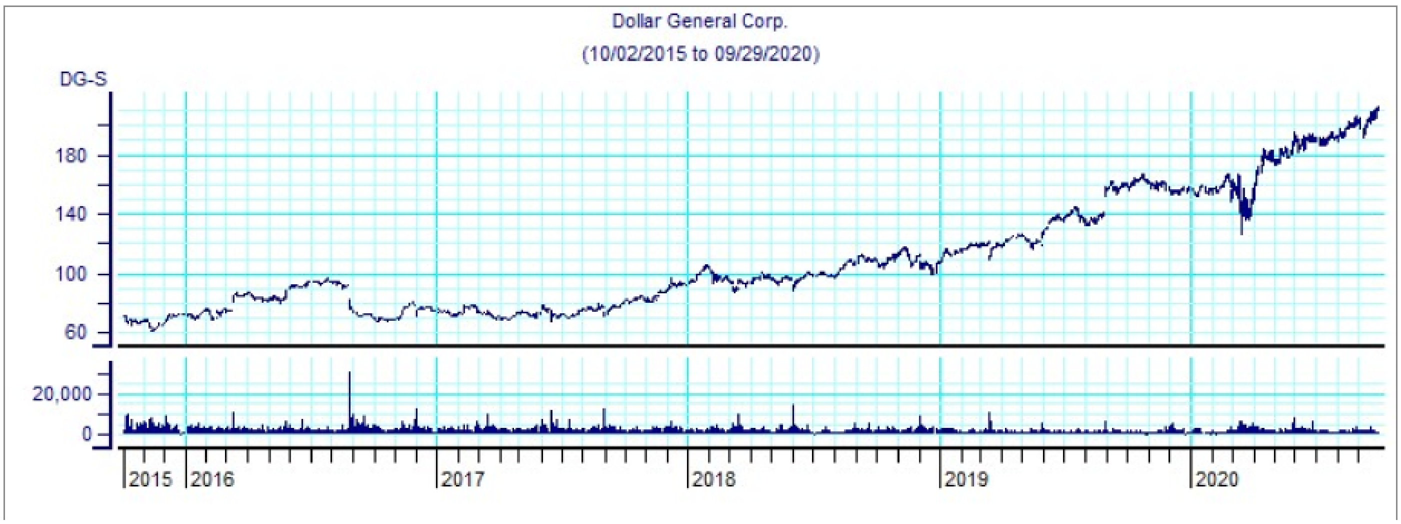
The Dollar General Corporation (DG) is the largest discount retailer in the United States by number of stores, with 9,961 stores located in 39 states, primarily in the southern, southwestern, midwestern and eastern United States. The company offers a broad selection of merchandise, including consumables, seasonal, home products and apparel. Its merchandise includes high quality national brands from leading manufacturers, as well as comparable quality private brand selections with prices at substantial discounts to national brands. They offer their merchandise at everyday low prices (typically $10 or less) through their convenient small-box (approximately 7,200 square feet) locations.

The company (DG) has attained a growth rate of 18.11% 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 33.51% despite a low debt to capital ratio of 35.73%. This stock provides the long-term stability and quality that Liberty Capital Management looks for over the long-term.

Dollar General Corp. (DG) NYSE — **Last 211.18**

100 MISSION RIDGE
GOODLETTSVILLE, TN 37072
Phone: 6158554000
www.dollargeneral.com

Price Change - YTD	35.39%
Dividend Yld	0.68%
P/E	22.95



Capitalization

% LT Debt to Total Cap	35.73 %
Owned by Institutions	92.60 %
Market Capitalization	52,589.69
Avg Daily Vol (Last 30 Days)	1,911,547

Business Overview

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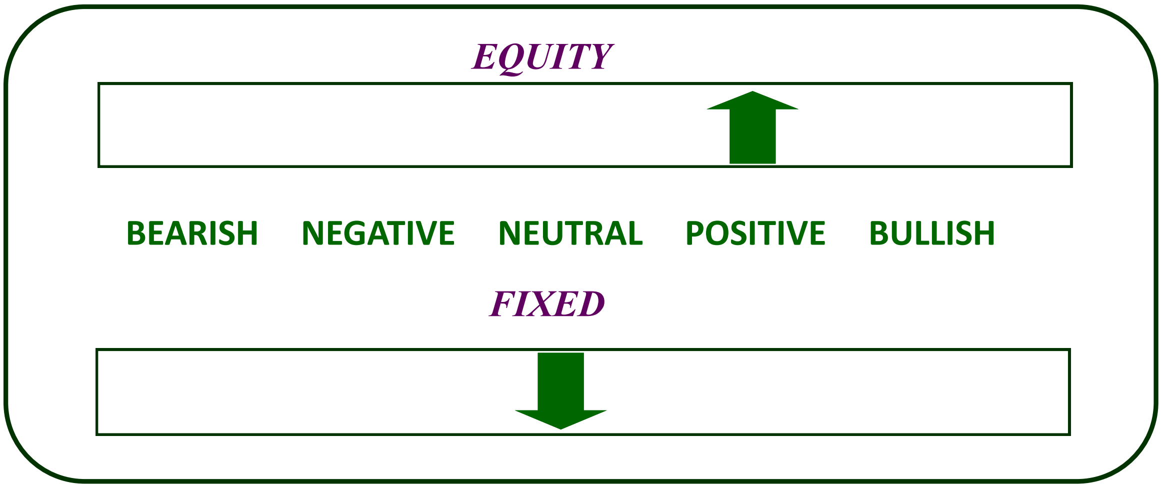
Earnings	$	%	Growth Rates
Latest Quarter	3.12 up	89.09%	5 Yr Historical
Latest 12 Months	9.20 up	19.02%	18.11%
S&P Consensus			LT Future
Current Quarter			
Current Fiscal Year			
Next Fiscal Year			
Revenues			5 Yr Historical
Latest Quarter	8,684 Mil up	24.38%	
Latest 12 Months	31,282 Mil up	5.76%	9.37%
Dividends			5 Yr Historical
Indicated Rate & Yield	1.44	0.68%	
Increases Last 5 Years	5.00		9.62%

Key Ratios & Measures	Current	High	5 Year Low	Avg
P/E	ADJ 22.95	ADJ 25.59	ADJ 15.12	ADJ 17.32
Price to Book	7.24	6.2	3.6	4.4
Price to Cashflow	13.26	18.0	11.2	14.4
Price to Sales	1.72	1.5	0.9	1.2
Return on Equity	33.51	29.0	0.0	24.0

BETA S&P 500 0.58

LIBERTY CAPITAL MANAGEMENT

MARKET BAROMETER



- Given the gradual opening of the economy, we should expect a gradual recovery. As more things open, growth should improve in sequence.
- Fixed income is generally used to help dampen overall volatility while providing returns that can out-pace inflation.
- At Liberty Capital Management, we are certain staying the course is the best option for investors. We will continue to do that for our clients.
- The end of the year is a good time to assess your financial situation.

~ Closing Figures as of September 30, 2020 ~

DJIA	**27781.70**	**10 yr. Treas.**	**0.67%**	**Funds Target**	**0.00% - 0.25%**
S&P 500	**3363.00**	**3 mo. T-Bill**	**0.091%**	**Prime Rate**	**3.25%**

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